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Washington, D.C.

Calendar No. 632

97TH CONGRESS
2d Session

SENATE

REPORT
No. 97-446

BANKRUPTCY IMPROVEMENTS ACT OF 1981

MAY 27 (legislative day, MAY 25), 1982.—Ordered to be printed

Mr. DOLE, from the Committee on the Judiciary, submitted the following

REPORT

together with

ADDITIONAL AND MINORITY VIEWS

[To accompany S. 2000]

The Committee on the Judiciary, which considered the bill (S. 2000) to make certain substantive changes to Public Law 95–598, the Bankruptcy Reform Act of 1978, having considered the same, reports favorably thereon and recommends that the bill as amended do pass.

I. PURPOSE OF THE BILL

The purpose of the bill is to make certain substantive changes in Public Law 95–598, the Bankruptcy Reform Act of 1978.

II. INTRODUCTION AND HISTORY OF THE BILL

On July 12, 1978, the Committee on the Judiciary reported S. 2226, the Senate version of the Bankruptcy Reform Act of 1978. On September 7, 1978, the Senate took from the desk H.R. 8200, the House version of the Bankruptcy Reform Act of 1978, struck the text of the bill and inserted in its place the text of S. 2266 and passed the bill as amended. On September 20, 1978, H.R. 8200, with further amendments, was passed again by the House. On October 5, 1978, the Senate repassed H.R. 8200, with additional amendments. Finally, on October 6, 1978, the House accepted the final Senate changes and cleared the bill for signature by the President. On November 6, 1978, President Carter signed the bill and it became Public Law 95–598. On October 1, 1979, Public Law 95–598 went into effect.

In the 97th Congress, on April 3 and 6, 1981, the Subcommittee on Courts, chaired by Senator Dole, held general oversight hearings on the Bankruptcy Reform Act of 1978. As a result of those hearings,

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numerous amendments, largely technical in nature, were proposed which were passed by the Senate as S. 863, the Bankruptcy Amendments Act of 1981 on July 17 of that year. Additional hearings were held on October 29, 1981. During the course of these hearings, judges, scholars, and bankruptcy practitioners testified as to the effectiveness of the new code as it applies to consumer debtors and suggested improvements. Comments centered upon provisions in chapters 7 and 13 governing redemption of collateral, reaffirmation agreements, federal exemptions, preferential transfers, and a number of additional, procedural sections of the code. Witnesses also raised concerns over the lack of statutorily mandated criteria for determining eligibility for bankruptcy, and expressed a desire for committee consideration of various proposals to require the bankruptcy court to evaluate the future earnings capability of a consumer petitioner in determining eligibility for chapter 7 relief. At the hearings held in October, the Subcommittee on Courts explored the ramifications of these proposals.

Reflecting a strong bipartisan effort, the subcommittee members after careful deliberation introduced on December 16, 1981, S. 2000, the Banktruptcy Improvements Act, which embodies many of those recommendations. S. 2000 was favorably voted out of the Subcommittee on Courts, with an amendment in the nature of a substitute offered by Chairman Dole accepted thereto, by a unanimous poll on February 12, 1982. The bill was placed on the committee calendar early in March, and was before the committee for several weeks prior to vote, during which time committee staff conducted discussions on areas of concern to members. As a result of those discussions, a number of amendments proposed by minority members of the committee (principally Mr. Metzenbaum) were accepted with modifications prior to final committee action. Agreement was reached in mid-April to poll the bill out of committee, and a poll was commenced but not completed due to unavoidable delay in the return of polling documents. (Prior to the termination of the poll, fifteen majority and minority votes were cast in favor of the bill with the amendments.) Finally, the committee approved reporting of the bill with amendments by voice vote on April 20, 1982. Senators Kennedy and Metzenbaum requested that their votes be recorded in the negative, and the clerk was so instructed.

III. Reasons for the Bill

In 1978, Congress enacted the Bankruptcy Reform Act, which included the Bankruptcy Code (containing the substantive law of bankruptcy) and a number of other provisions relating to bankruptcy administration. The Bankruptcy Reform Act was the first major revision of the bankruptcy laws of the United States since 1938, and its enactment was the culmination of an effort that extended over a number of years. The new code resulted in numerous substantive changes in the law of bankruptcy as well as in the administration of debtor's estates.

Most of these new provisions have worked well and have had beneficial effects. However, it became clear soon after the new code became effective that the changes wrought by the 1978 law in certain areas have disrupted the delicate balance of equity between debtors and creditors, particularly with respect to consumer credit transactions. It is the

committee's view that these imbalances are already having serious economic and social repercussions that call for remedial legislation.

One event of great concern since passage of Public Law 95–598 has been the dramatic, unparalleled, and constant increase in the number of consumer bankruptcy cases filed each year, and the substantial pressure on the consumer credit industry which has resulted. Data from the Administrative Office of the U.S. Courts reveals the following:

TABLE 1.—INDIVIDUAL BANKRUPTCIES FILED [1] (EXCLUDING BUSINESS FILINGS) FISCAL YEARS 1966–81 [2]

Year	Number of estates	Percent change (rounded)
1966 (to June 30)	175,924	
1967	191,729	+9
1968	181,266	−5
1969	169,500	−7
1970	178,202	+5
1971	182,249	+2
1972	164,737	−10
1973	155,707	−6
1974	168,767	+8
1975	224,354	+28
1976	211,348	−6
1977	182,210	−14
1978	172,423	−6
1979	196,976	+12
1980	314,856	+60
1981 (to June 30)	452,145	+43

[1] Statistics reflect total number of individuals seeking relief under the bankruptcy laws from collection of personal debts.
[2] July 1 to June 30.

Source: Administrative Office, U.S. Courts.

There is no doubt that part of the 103-percent increase in nonbusiness cases since the end of fiscal year 1979 results from factors other than the Bankruptcy Code. For example, the combined effects of sluggish economic conditions and continued inflation certainly have contributed to the increase in bankruptcy filings. Several witnesses at the subcommittee hearings suggested that lawyer advertising, now permitted by the Supreme Court's decision in *Bates* v. *State Bar of Arizona*, 433 U.S. 350 (1977), also has contributed to the upsurge.

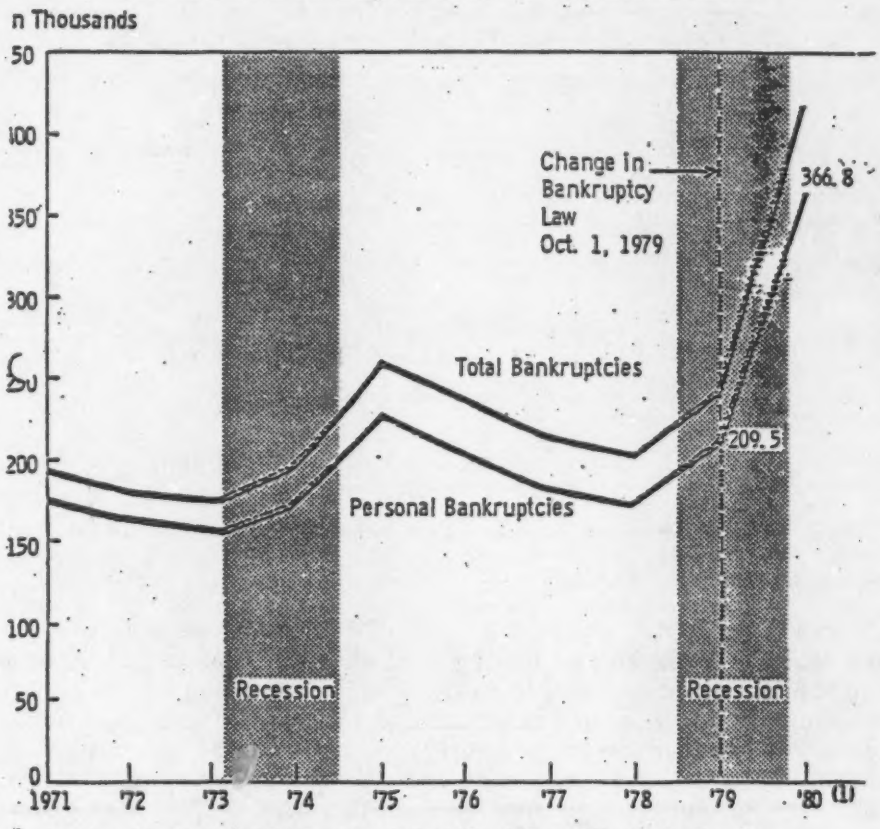
These factors, however, simply do not explain the unprecedented increase in bankruptcy cases. Instead, it is apparent that provisions of the code have played a substantial role in stimulating the number of bankruptcy filings. The startling increase in the number of bankruptcies since the code went into effect (which past experience suggests is out of proportion to the changes in other economic indicators) does not permit the committee to attribute the rise solely to economic conditions. If that were the case, it could be expected that the economic problems would exert a gradual, upward pressure on the number of filings.[1] This is not, however, the case; rather, there has been a dramatic surge in the number of filings which coincides neatly with the adoption of the code.

One example of the imbalance in bankruptcy filings is found in the unemployment statistics for present and past periods of recession. Although bankruptcy filings tended to parallel unemployment figures before the advent of the code, this is no longer the case. The following charts illustrate:

[1] This might not be true if some catastrophic economic event precipitated large numbers of filings at one time. No testimony before the subcommittee sought to explain the increase on this basis.

Table 2

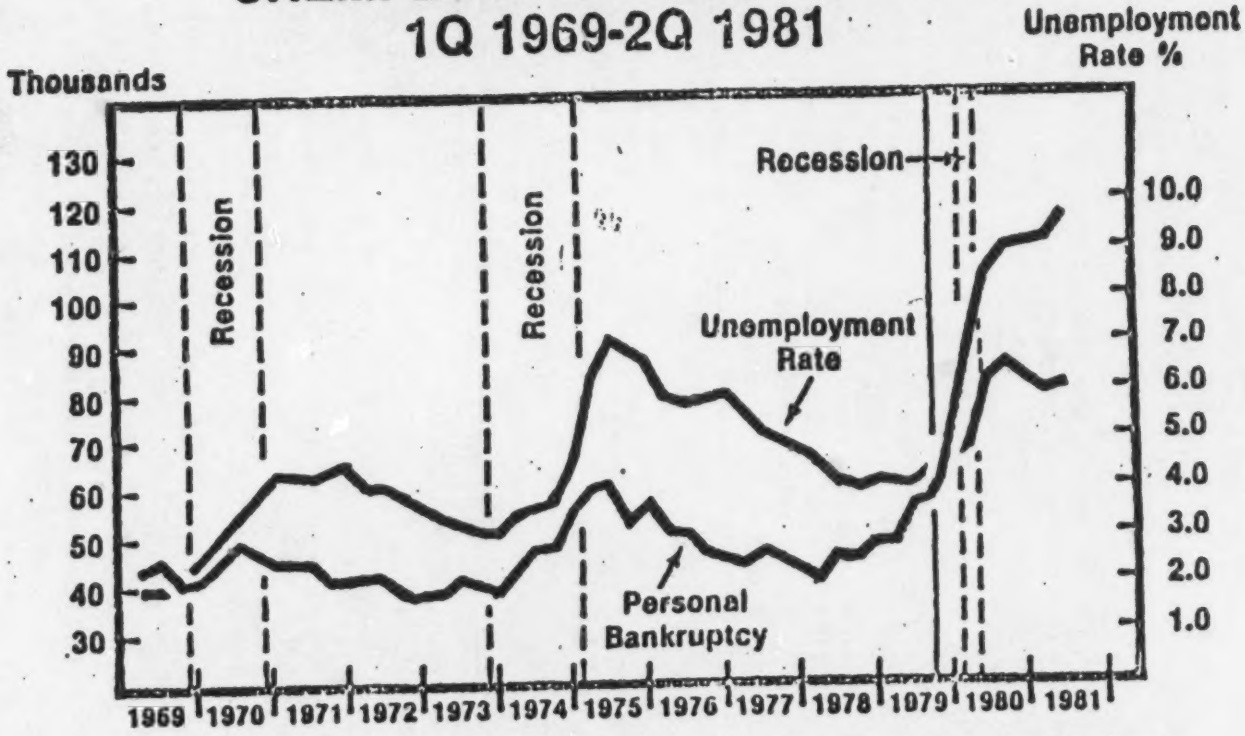
Volume of Bankruptcies in the United States



Source: Bankruptcy Division, Administrative Office of the U. S. Courts

(1) Includes joint filings counted as 2 single filings

PERSONAL BANKRUPTCIES vs. UNEMPLOYMENT QUARTERLY, 1Q 1969-2Q 1981



Source of Bankruptcy Data: Bankruptcy Division, Administrative Office of the U.S. Courts

Table 3

The figures concerning nonbusiness petitions filed monthly show the following:

Year:	Average monthly filings (individuals)
1979	19,044
1980	34,149
1981 (6 mo)	38,092

The ever-increasing number of bankruptcies, and the resultant financial losses, constitutes a general burden on the economy of billions of dollars annually.[2] In the short term, these costs are shifted from debtor to lender (and stockholders and owners of the institutions providing credit). In the long run, however, creditors will not continue to bear the losses; instead, the realities of the marketplace will force them to seek greater protection by increasing the cost of obtaining credit, requiring additional collateral or cosignors, and/or reducing their financial risks by eliminating some transactions completely. For example, testimony by credit industry experts revealed that some consumer credit companies—which previously made loans which were secured only by personal property—now are making a large proportion of loans secured by second mortgages on the consumer's residence. As a consequence of such creditor responses, credit will become more difficult to obtain, and the general cost of doing business will escalate. Such a result is directly at odds with congressional efforts to make credit more widely available—for example, by statutes such as the Equal Credit Opportunity Act, and the Fair Credit Reporting Act.

The overall social and economic cost of such trends is that the people most in need of credit may be driven to illegal lenders, and those individuals who pay their debts end up subsidizing those who do not to a greater extent than would be the case under normal circumstances. This result is not fair and not acceptable.

The above facts suggest an unprecedented number of consumer bankruptcy filings and a concomitantly high level of bankruptcy losses. These trends would not warrant any change in the bankruptcy laws if the evidence showed that the bulk of persons filing bankruptcy simply had no choice—that they were financially "driven to the wall." The purpose of bankruptcy relief is to enable the honest but unfortunate debtor to obtain relief from burdensome debt. Excessive debt is a serious social problem which may result in a number of interrelated personal, economic, and family difficulties, and can cause the debtor to withdraw from the productive segment of the economy; thus, it is in the public interest to discharge persons who have incurred unmanageable financial burdens.

At the same time, it is essential to public acceptance of the Bankruptcy Reform Act that the law be seen to fairly balance the legitimate interests of all parties to bankruptcy proceedings, so as to insure that the structure of the law itself does not encourage the filing of petitions which are not justified by economic necessity. In this regard, the committee received ample testimony from representatives of the credit industry who articulated a number of concerns about certain provisions of the Reform Act which have served to tilt the balance of equities against the bona fide creditor to an extent which has resulted in significant enhancement of the lender's risks beyond a level which can

[2] Witnesses before the subcommittee testified that total bankruptcy losses for 1981 may exceed $6 billion.

be reasonably absorbed without threatening the availability of credit. In addition, testimony revealed a need for certain changes in bankruptcy procedures which would contribute to more efficient and economical administration of the law.

The bill reported by the committee seeks to restore balance and efficiency to the Bankruptcy Code; and, while the principal objective of the legislation is the elimination of those defects in the code which constitute unnecessary obstacles to the attempts of good faith creditors to recover upon lawful claims in bankruptcy, every effort has been made to ensure that the legitimate interests of debtors who are indisputably in need of bankruptcy relief remain protected.

IV. Testimony in Support of the Bill: Problem Areas

A. Eligibility of Individual Debtors for Chapter 7 Relief

Extensive testimony was offered at committee hearings held on October 29, 1981, concerning the question of whether or not the future earnings capabilities of individual debtors should be taken into account in determining eligibility for chapter 7 relief. In general, bankruptcy practitioners, representatives of the judiciary, and representatives of the credit industry agreed that a percentage of individuals filing in chapter 7 had a substantial repayment capability when anticipated future earnings were taken into account in evaluating the total financial position of the debtor. There was sharp disagreement, of course, on the size of that group.

Various proposals for factoring future earnings into the determination of eligibility for chapter 7 were put before the committee for consideration. It is clear that the incorporation of anticipated future earnings into the present eligibility requirements set forth in section 109 of the Code would represent a significant departure from present bankruptcy law, which does not contain any requirement of actual insolvency on the part of the individual debtor seeking chapter 7 relief. The committee is cognizant, however, of the potential savings which could be realized by the changes proposed—savings in the form of averted losses. Thus, the committee felt compelled to conduct a thorough cost/benefit analysis of this concept.

In examining the financial status of persons filing under chapter 7, it is obvious that most debtors have little prospect of paying any reasonable portion of their debts out of future income. The debtor's continuing obligation to provide support for himself and his family frequently exhausts the debtor's available income, and the debtor will often not have any substantial discretionary income left after satisfying these basic living expenses; or, the debtor may have suffered such serious financial reverses from illness, income reductions, or family difficulties, that any possibility of repayment is ephemeral. No purpose is served by continuing to burden such debtors with legal obligations which they simply cannot satisfy. At the other extreme, however, lie a substantial percentage of debtors who are not financially incapacitated at the time of filing bankruptcy, and for whom a discharge in bankruptcy constitutes a "head start" rather than a "fresh start" when their expectation of substantial future earnings is taken into account.

The most comprehensive and competent evidence of these facts was provided by the testimony of Dr. Robert Johnson, director of the Credit Research Center, located at the Krannert School of Management at Purdue University. Professor Johnson, in conjunction with the consulting firm of Arthur D. Little, Inc., conducted a comprehensive study of persons who had filed bankruptcy petitions. The study involved not only the collection and examination of financial data concerning a substantial sample of recent debtors in 10 States across the country, but personal interviews with almost 1,200 individuals filing for chapter 7 relief.

The findings of the Credit Research Center study suggest that a substantial minority of persons who file chapter 7 bankruptcy petitions have considerable debt-paying ability. To focus this issue, the research center considered the present and expected income and debts of each debtor, the percentage of income needed for housing and other basic living expenses of the debtor and his dependents, and determined from this information whether or not there was any excess discretionary income that might be used by the debtor for the repayment of debt out of the future income anticipated by the debtor. The calculations of what the debtors' anticipated future income would be were based upon information provided by the debtors personally interviewed as to what their expectations of future earnings were. In calculating expenses, Dr. Johnson allowed the debtor's actual expenses for housing, factored in the Department of Labor estimate for basic living expenses for the debtor and his immediate family in the locale of the debtor's residence, and added any extraordinary expenses such as unusual medical obligations, alimony, or child support payments. Calculations were also made allowing an additional 20 percent of nonhousing expenses estimated as a cushion for unexpected hardship.

The results of the study revealed that a substantial number of debtors could pay a significant portion of their debts over a period of 36–60 months. The major findings were as follows:

1. More than 15 percent of all debtors in chapter 7 could pay their debts (excluding purchase money mortgage debt on the debtor's principal residence) in full over a peirod of 3 years on a deferred payment plan, using the most liberal expense level calculations.

2. About 25 percent of such debtors could pay at least half of their debt (excluding purchase money mortgage debt on the debtor's principal residence) over a period of 3 years on a deferred payment plan, using the most liberal expense level calculations.

3. Bankruptcy losses might be reduced by as much as $1.6 billion if eligibility for chapter 7 relief were limited to persons who could not pay a reasonable portion of their debts out of future income.

The results of the Credit Research Center study are summarized in the following tables and charts.

TABLE 4.I—PERIOD OF TIME REQUIRED TO REPAY NONMORTGAGE DEBTS IN FULL FROM AVAILABLE INCOME[1]

[Percentage of debtors]

	Basic living expenses			Basic living expenses plus 20 percent of nonhousing expenses		
	N[2]	Percent	Cumulative percentage	N	Percent	Cumulative percentage
Total nonmortgage debt repayable in:						
0 to 12 mo	47	4.4	4.4	32	3.0	3.0
13 to 24 mo	96	9.0	13.4	79	7.4	10.4
25 to 36 mo	77	7.2	20.5	51	4.8	15.1
37 to 48 mo	61	5.7	26.2	51	4.8	19.9
49 to 60 mo	32	3.0	29.2	32	3.0	22.9
More than 60 mo	758	70.8	100.0	826	77.1	100.0
Total	1,071	100.0		1,071	100.0	

[1] Available income equals reported before-tax income, minus alimony, minus social security taxes, minus Federal income taxes, minus reported housing expenses (mortgage or rental payments, fuel and utilities, insurance, and property taxes), minus minimum income needs specified by Federal standards for nonhousing expenditures, minus other required monthly expenditures (child care, excess child support and excess medical expenses).

[2] Those cases were excluded in which it was found impossible to calculate a consumer's ability to repay debt because critical information was missing.

Note: Details may not add to total because of rounding.

Source: "Credit Research Center Bankruptcy Study."

TABLE 5.—NONMORTGAGE DEBTS[1] THAT COULD BE REPAID IN 36 MO FROM AVAILABLE INCOME

[Percentage of debt; percentage of debtors]

	Basic living expenses			Basic living expenses plus 20 percent of nonhousing expenses		
	N	Percent	Cumulative percentage	N	Percent	Cumulative percentage
Nonmortgage debt repayable in 36 mo:						
100 percent or more	217	20.3	20.3	159	14.9	14.9
75 to 99.9 percent	61	5.7	26.0	51	4.8	19.6
50 to 74.9 percent	57	5.3	31.3	55	5.1	24.8
25 to 49.9 percent	80	7.5	38.8	77	7.2	32.0
0 to 24.9 percent	97	9.1	47.9	87	8.1	40.1
None	558	52.1	100.0	641	59.9	100.0
Total	1,070	100.0		1,070	100.0	

[1] Nonmortgage debt excludes mortgage and business debts.

Note: Details may not add to totals because of rounding.

Source: "Credit Research Center Bankruptcy Study."

TABLE 6.—NONMORTGAGE DEBTS[1] THAT COULD BE REPAID IN 60 MO FROM AVAILABLE INCOME

[Percentage of debtors]

	Basic living expenses			Basic living expenses plus 20 percent of nonhousing expenses		
	N	Percent	Cumulative percentage	N	Percent	Cumulative percentage
Nonmortgage debt repayable in 60 mo:						
100 percent or more	310	29.0	29.0	242	22.6	22.6
75 to 99.9 percent	44	4.1	33.1	38	3.6	26.2
50 to 74.9 percent	46	4.3	37.4	46	4.3	30.5
25 to 49.9 percent	53	5.0	42.3	57	5.3	35.8
0 to 25.9 percent	59	5.5	47.9	46	4.3	40.1
None	558	52.1	100.0	641	59.9	100.0
Total	1,070	100.0		1,070	100.0	

[1] Nonmortgage debt excludes mortgage and business debts.

Note: Details may not add to totals because of rounding.

Source: "Credit Research Center Bankruptcy Study."

TABLE 7.—MEAN PRETAX INCOME OF DEBTORS AND NONMORTGAGE DEBT THAT COULD BE REPAID IN 60 MO

	Mean pretax income [2]	Mean nonmortgage debt
Percentage of nonmortgage debt repaid: [1]		
100 percent or more	$17,058	$11,945
75 to 100 percent	15,335	19,420
50 to 75 percent	14,687	30,061
25 to 50 percent	13,374	41,417
0 to 25 percent	10,802	28,397
None	5,650	18,776

[1] Assuming coverage of basic living expenses.
[2] Before taxes and transfers.

Source: "Credit Research Center Consumer Bankruptcy Study."

The Credit Research Center study thus concludes that a substantial percentage of debtors could pay a considerable portion of their debts out of future income. This implicitly suggests that many persons are seeking relief in chapter 7 who do not need the scope of protection afforded by that chapter.

Who are the chapter 7 debtors? Professor Johnson testified that the Credit Research Center study revealed that 72 percent of all debtors surveyed were employed full time, and almost all expected to have the same, or higher income 6 months after the interviews (which were conducted immediately following the first meeting of creditors). Moreover, the mean annual pretax income of the persons who could repay 100 percent, or between 75 and 100 percent of their debts, was $17,058 and $15,335, respectively. In short, most of these persons are not living at or near the poverty level.

These conclusions are borne out by the results of a survey of 1,645 debtors conducted by Andrew Brimmer & Co. in another study of bankruptcy filings between the period of 1969 and 1980. This study found that 84 percent of the debtors had completed at least high school, and almost 12 percent had finished college (nationally only 40 percent of all Americans complete high school, and less than 8 percent finish college); that 78 percent of the respondents were employed when they filed for bankruptcy; and less than 2 percent of the bankrupt debtors were retired. Over 74 percent of the bankrupts were between the ages of 25 and 44 (nationally, only 37 percent of the population is between such ages). These figures indicate that the typical bankrupt seems to be better educated, and more middle aged than the average American, and almost as equally employed.

The Brimmer survey further demonstrated that almost 18 percent of the bankrupts had annual family income above $20,000; 13 percent of the respondents held assets valued at over $20,000; and 23 percent had debt in excess of $20,000. These statistics, coupled with the response that "using too much credit" and "overspending" were the two reasons most cited for filing bankruptcy (ahead of "loss of job," "marital difficulties," "medical expenses," and "business failures"), imply that the debtor's difficulties are quite often of his or her own making.

As reflected by the Brimmer survey, attitudes of many debtors further indicate a certain irresponsibility and nonchalance toward the entire concept of bankruptcy. When asked what social impact bank-

ruptcy had on debtors and their families, an amazingly high 65 percent responded that there was none. Moreover, 12 percent of the respondents believed that bankruptcy had no financial effect on them or their families.

Finally, the Brimmer study evaluated the factors affecting the growth surge in bankruptcy filings since the passage of the new code. Andrew Brimmer offered the following observations in regard to this aspect of the committee's inquiry:

> In our judgment, there is no way whatsoever to explain the ballooning of bankruptcies in the last few years by references to economic conditions. * * *
>
> * * * Let me say quickly that we calculated the long-term trend of bankruptcies and concluded that the trend alone would yield no more than 1,000.
>
> We also asked whether the deteriorating economy in 1979 and the sharp recession in 1980 might offer a reasonable explanation of the sharp rise in bankruptcies.
>
> Having done that analysis, we concluded that there was no basis whatsoever to attribute the sharp rise to the deteriorating economy alone. At best, the recession, even if it had been as severe as the recession of 1974–75, would have produced no more than an additional 50,000 to 55,000 extra bankruptcies in 1979–80 on the average.
>
> So we ended up with about 136,000 to 151,000 extra bankruptcies that cannot, in our judgment, be explained by either the trend or economic conditions.[3]

Witnesses testifying at the subcommittee hearings questioned whether the increase in bankruptcies might be accounted for by consumer lending practices which encourage overextension of credit. In response, credit industry spokesmen pointed out that the ratio of consumer credit outstanding to consumer liquid assets has remained largely unchanged during the past 20 years, with total credit fluctuating from between 18 to 22 percent of liquid assets in that period of time. (See chart below.)

In current dollar terms, consumer installment credit outstanding increased from $44 billion in the third quarter of 1960 to more than $328 billion in the third quarter of 1981, a compound growth rate of 10 percent over the period. Of this amount, over 126 billion (approximately 38 percent) represented automobile credit. Undoubtedly, both demand factors (such as population growth, greater willingness to incur debt, and so forth) and supply conditions (such as greater willingness to make unsecured credit available to consumers) account for the significant increase in the total dollar value of outstanding credit. However, consumers' income and assets have grown rapidly as well: from $404 billion in the third quarter of 1960, personal income rose to $2.5 trillion by third quarter 1981, a compoud gowth rate of 9 percent. (Information courtesy Federal Reserve, Department of Commerce.)

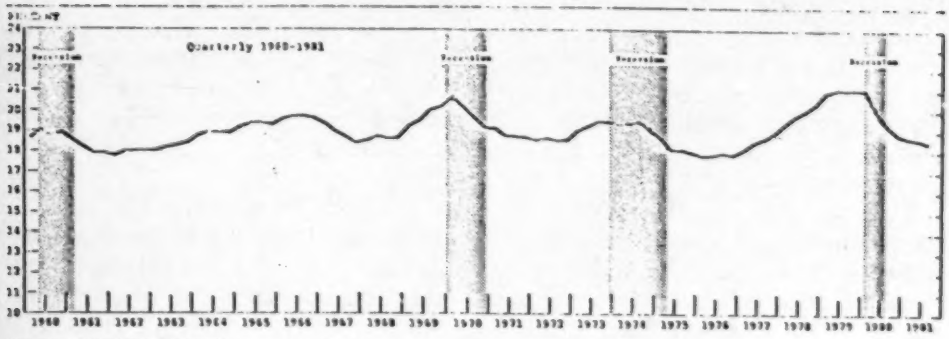
[3] Brimmer testimony, "Hearings on the Bankruptcy Reform Act of 1978," serial No. J–97–11, pt. 1, p. 8. The Johnson and Brimmer studies have been further corrobrated by studies performed by the Atlanta Federal Reserve Board; the Saginaw, Michigan Association of Credit Unions; and the Family Debt Counseling Bureau of Baton Rouge, La. Cf., Hearings Record, pt. 3.

The ratio of credit to assets peaked at about 21 percent in 1979 and has declined gradually to around 18.5 percent (third quarter, 1981). The range of 18.5–19 percent during the calendar year 1981 is analogous to the ratios prevalent during the last year of the Eisenhower administration. Rather than indicating increased tightness in the consumer sector in recent years, this suggests that households have consistently maintained their installment debt levels at about 20 percent of liquid assets.

Further evidence of overall stability in the levels of consumer debt obligations is found in a comparison of consumer installment borrowing as a percentage of disposable income. The ratio of consumer installment credit repayment obligations to personal disposable income is frequently referred to by analysts as the consumer's "debt burden". The term "repayments" as used here means repayments made, usually monthly, on consumer installment credit including automobile credit, revolving credit, mobile home credit, and personal loans. Disposable income refers to personal income available for spending—that is, personal income less payments for taxes and social insurance. Available information (Federal Reserve, Department of Commerce) indicates that the debt burden ratio rose slightly during the 1960's from about 13 percent in 1960 to about 16 percent in 1970. After 1970, the ratio declined until mid-1975 when it slipped below 14.5 percent. From this low the ratio rose again, reaching a second peak in the 16+-percent range in 1978. Since 1978, debt burden has declined sharply and steadily, reaching 14 percent at yearend 1981, a level not seen since early 1963. (See chart below).

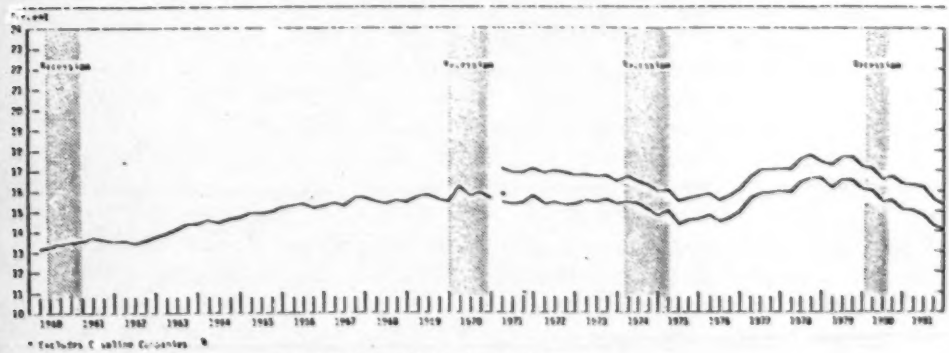
The following charts illustrate these points:

Ratio of Consumer Installment Credit Outstanding
to Consumer Sector's Liquid Assets



Sources: Federal Reserve Board

Ratio of Repayments of Consumer Installment Credit
to Disposable Personal Income



Source: Federal Reserve Board and Department of Commerce

Thus, although the amount of consumer credit outstanding has increased in constant dollars by a substantial percentage during the past generation, it is clear that there has been no significant change in the debt burden of consumer debtors. In fact, as the charts above make clear, periods during which the amount of consumer debt (in comparison to assets and personal disposable income) did fluctuate upward were not accompanied by substantial changes in the rate of bankruptcy filings; yet, commencing in 1979, the ratio of debts to assets and income declined while the percentage of bankruptcy filings dramatically increased.

The present Bankruptcy Code looks only to the debtor's ability to pay debts out of present assets, and requires the debtor to surrender his nonexempt assets as a condition of bankruptcy relief. In contrast, consumer credit is not extended against the liquidation value of present assets, but rather, on the assumption that the debts will be paid out of future income. As presently structured, then, the Bankruptcy Code is at odds with the modern trends in the consumer finance industry.

Judge Conrad Cyr, speaking of the need to clarify the standards for confirming chapter 13 plans, has given the most eloquent statement of this inconsistency:

> Consumer credit is seldom extended in reliance upon the debtor's present net worth, this is, the present value of unencumbered assets, but on basis of future income. * * * [The Code permits the] debtor, unilaterally, on a demand and without demonstrated need, to alter or nullify the entire credit transaction, notwithstanding the fact that the ability of the debtor to pay has not deteriorated and may even have improved.
>
> A legal procedure at such cross purposes with the economy it regulates runs the risk of falling into disuse due to its own irrelevance, or, more importantly, threatens actual deflection of powerful economic forces at work in the consumer credit marketplace. The devastating social and economic impact of a return to pre-World War II net worth consumer credit extension policies needs no elaboration. It would seem a sound policy to conform the insolvency system to the economic system, especially since the reality is that consumer credit represents a primary driving force in American society.
>
> Additionally, there is little, if any, quarrel with the view that the law should encourage debtors voluntarily to repay their just obligations to the extent reasonably able to do so. The ethical premise upon which this near-universal view is based is the core of our consumer credit system.[4]

In consideration of this evidence, the committee has concluded that the present bankruptcy laws, by failing to take future earnings capabilities into account in determining eligibility for chapter 7, have contributed to abuse of the bankruptcy system by individuals who are not actually in need of straight liquidation relief.

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[4] Cyr, "The Chapter 13 'Good Faith' Tempest: Analysis and Proposal for Change," 55 *Am. Bankr. L.J.* 271, pp. 280–281 (1981).

B. SECTION 341(C) MEETING OF CREDITORS

A serious administrative problem that has arisen under the new code is the provision in section 341(c) which prohibits the judge from presiding at, or attending, the meeting of creditors.

This provision was designed to help remove the judge from the day-to-day administration of bankruptcy proceedings. There was some concern that involvement of the bankruptcy judge in routine questioning of the debtor and administrative matters would result in the consideration of evidence outside the context of any dispute which the judge might later be called upon to decide. There was also concern that much of the evidence the judge might hear would be inadmissable in subsequent adversarial proceedings.

Unfortunately, however well intended this provision may be, there is evidence that the complete prohibition contained in section 341(c) hampers effective and speedy administration of the Bankruptcy Code. The new code fails to recognize that under the prior bankruptcy law, the judge performed vital judicial functions at the meeting of creditors. Under the new code, which mandates the absence of the judge at all times, these important functions are ignored. Meetings must be continued while the parties seek resolution of such problems as disputes over the scope of examination of the debtor, deficiencies in the debtor's petitions and schedules, or, in consumer cases, disputes regarding redemptions and reaffirmations. Separate proceedings to resolve these disputes have resulted in consistent delay and substantial additional expenses for trustees, debtors, and creditors. Speed and efficiency are vital; delay results in devaluation of assets, unnecessary hindrance to financial rehabilitations, and prevents parties in interest from exercising their rights expeditiously.

Some witnesses emphasized the importance of keeping the judge removed from the day-to-day administration of the bankruptcy case: this is a burden that should not be placed on judges. Consequently, these parties opposed a requirement that judges should preside at all times in a meeting of creditors.

The committee is of the opinion that the need for efficient and speedy administration of cases must be carefully balanced against the need to avoid overburdening the judge with administrative aspects of the case. The solution lies in providing the parties an opportunity to have disputes resolved at the meeting of creditors while affording the judge the flexibility in attendance at the meeting necessary to provide for efficient administration and performance of such judicial responsibilities as may be required under the Code, or necessary to a given proceeding, while, at the same time, avoiding undue involvement in purely administrative matters.

A requirement that the court convene the meeting would provide opportunity for parties to present immediate disputes to the judge for resolution. It would also allow for the elimination of the discharge and reaffirmation hearings—as discussed below—as the functions performed at those hearings could be folded into the first meeting. The committee bill so provides.

C. VALUATION OF COLLATERAL ON SECURED CLAIMS

The existing provisions of the Bankruptcy Code (S. 506 (a)) stipulate that the value of the property of a debtor's estate must be determined on the basis of the proposed disposition or use of that property. The committee, after review of the testimony detailing experience with the valuation provisions of the 1978 Code, has concluded that the courts have, in too many cases, undervalued collateral property to an extent which denies adequate protection to secured creditors. Problems of proof which creditors face are compounded by judicial confusion over what standard should be employed—wholesale or retail, resale or straight line depreciation. Many courts have fixated upon wholesale resale as the appropriate standard, even for property with a high resale value in the retail market. Whereas the Bankruptcy Reform Act sought to encourage valuation on a case-by-case basis in focusing on the proposed use of the property in question as a determinant factor, the original intent of the Congress in this regard has not uniformly been carried into practice by the courts. Cf., In re *Crockett*, 3 B.R. 365 (Bk., N.D. Ill., 1980); In re *McLeod*, 5 B.R. 520 (Bk. N.D. Ga., 1980).

The committee has concluded that further elaboration of congressional intent is required in order to dispel confusion. Thus, the proposed bill specifies the preference of the Code for use of a resale market standard, with the choice of wholesale or retail measurements of value to be determined by reference to the condition of the property and the debtor's proposed use or disposition thereof. In either case, the committee bill encourages reference to trade publications as appropriate indicia of the market value of the property in question. The bill contemplates the utilization of other standards of valuation where such standards may provide for more equitable treatment of the parties than reference to the resale market would afford. For example, scheduled depreciation would be appropriate where a debtor seeks to redeem specialized manufacturing or processing equipment, peculiar to the detbor's business or profession and specialized needs, which has a limited or nonexistent resale value. In such situations, the debtor's proposed continued use of property of substantial utility militates against the use of any valuation scheme that does not provide a return to the creditor commensurate with the benefits afforded to the debtor by the redemption provisions of the section. Conversely, where the property in question has suffered substantial depreciation and is of limited use to either the debtor or creditor, liquidation value would be appropriately applied.

In all, the committee believes that the provision of the bill will help to bring about more uniform valuation practices in the courts and allow for greater predictability in valuation determinations.

D. DEBTOR DISPOSITION OF SECURED PROPERTY

Hearings before the Subcommittee on Courts revealed that one of the most severe problems created by the Code lies in the inadequate mechanisms for enforcement of rights of creditors which are not disputed. That is, the Code imposes such high "transaction costs" on the enforcement of certain rights, that the rights themselves become of

little value. This is most clearly the case in connection with the rights of creditors who have a security interest or lien upon the debtor's property which is enforceable in bankruptcy. In most cases, these rights are themselves not disputed or questioned.

When the debtor files a bankruptcy petition, property which is collateral to a secured debt is frequently—in fact usually—retained by the debtor. The debtor generally has several options with respect to such property: He may claim the property as wholly or partially exempt, may seek to redeem the property, or may seek to retain the property by reaffirming all or part of the underlying debt. Or, the debtor may decide to surrender the property to the secured creditor. The trustee also has a potential interest in such property, although this interest is largely theoretical. In the typical case, the property will be worth less than the amount of the debt, and the trustee will disclaim any interest in the property.

Under normal principles of commercial law, if a consumer does not pay a secured debt, the creditor can take either judicial or nonjudicial steps to recover the collateral. Unfortunately, when the debtor files a bankruptcy petition, the Code provides no orderly, expedited mechanism for enforcing the undisputed interest of the secured creditor. The debtor himself is not required to return the property or exercise one of the other options by a designated time. Theoretically, the secured creditor could request this relief at the meeting of creditors, but attendance at the meeting should not be necessary to get the debtor to elect one of his options.

Alternatively, the matter might be resolved by contacting the trustee, and some have argued that the trustee has a duty to pick up and deliver secured property. Testimony has indicated that in practice, nothing of the sort is taking place. The trustee often is unfamiliar with secured claims, and usually intends to abandon the property since its value is less than the creditor's lien; therefore, trustees are reluctant to expend estate assets to benefit secured claimants. Often, since there are minimal amounts available to pay priority claims, trustees would not be fully compensated for such efforts on behalf of secured creditors.

The secured claimant is barred from the kind of direct action permitted under normal principles of commercial law, as both before and after the meeting of creditors, the automatic stay bars direct communication with the debtor. This is a particularly acute problem if the debtor is not represented by counsel, in which case there is no one to speak with at all, or if the debtor is represented by counsel who cannot be reached or who is not familiar with the particulars of the case involving the secured claimant. Prior to discharge, the automatic stay clearly prohibits any attempt to seize the property unless the creditor takes affirmative action in the court, which usually requires the filing of an adversary proceeding.

Evidence demonstrates that under the present Code provisions, there is a hiatus of from several weeks to many months during which the debtor has possession of the property, uses the property, and is not required to make any effort to resolve the interest of the secured creditor. During that time, the property will depreciate in value due to normal use, and may be lost or destroyed. Ultimately, if the interest is not resolved, the secured creditor must incur the considerable expense

of bringing a separate proceeding to obtain relief from the stay so that the lien can be enforced. Creditors have stated that the costs of such a proceeding rarely are less than $350, and may be considerably more if several court appearances are required. Morever, the debtor continues to retain and use the property for the time it takes to conclude the proceeding. This is a clear instance where the code has imposed excessive costs on secured creditors who seek to enforce their undisputed rights to secure property. The costs are not imposed so that the debtor can exercise rights of his own; rather, there simply are no procedures for resolving such rights at an early stage of the proceedings at the least possible cost. The effect of the present scheme is to diminish substantially the rights of secured creditors, and, in many instances, entirely deprive them of their security.

This committee recognizes that secured creditors have a substantial, and perhaps even paramount, interest in collateral property.[5] Accordingly, the debtor should, in the committee's view, be required to notify the secured creditor of his intentions with respect to the property within a reasonable period of time after the filing of the petition, and then, to perform his stated intention by the time of the meeting of creditors. In situations where there is a dispute over the respective rights of debtor and secured creditor, or in the rare case where the trustee will assert an interest of the estate in such property, the court can order the status quo to be maintained until any disputed matters are resolved.

E. EXEMPTIONS

A number of witnesses expressed concern at the hearings over the federal exemptions as found in section 522(d). The new Code introduced a list of Federal exemptions into the bankruptcy law for the first time. Under prior law, property exemptions in bankruptcy proceedings were generally determined under State law. In promulgating a system of Federal exemptions, Congress was concerned that many state exemption laws had not been substantially revised in recent years to adequately serve the needs of individuals and to provide the fresh start contemplated in the bankruptcy proceeding. The historical purpose of exemptions was to provide a debtor with the basic necessities of life so that, after bankruptcy, the debtor could begin, or continue to lead, a productive life.

By enacting a list of federal exemptions and providing States with the option to specifically reject the list of federal exemptions, Congress sought to encourage the states to reexamine their exemption laws and bring them up to date. Congress clearly adhered to the view that the states were in the best position to determine what particular exemptions were needed for a "fresh start" in each particular locale and condition.

As with any new idea or concept, substantial problems have arisen with the federal exemptions. Three aspects of the list of federal exemptions were particularly criticized at the hearings as allowing a debtor to retain significantly more property than was needed to remain or become a productive member of society.

[5] See *Mitchell* v. *W. T. Grant Co.*, 416 U.S. 600 (1974).

First, creditors criticized the ability of joint petitioners to make separate elections regarding exemptions under the federal law or under the state law. In many cases this provision allows married couples to take unfair advantage of the most liberal provisions in both state and federal law: for example, one individual can take advantage of a liberal state homestead exemption designed to serve an entire family, while that person's spouse can take advantage of the liberal federal exemption regarding household goods.

Second, the provisions regarding household goods were particularly critized by creditors. Section 522(d) of the Code allows a debtor to exempt any interest in any patricular item of household furnishings, household goods, wearing apparel, appliances, books, animals, crops, or musical instruments that are held primarily for the personal, family, or household use of the debtor or his dependents, so long as the value of any specific item exempted does not exceed $200 ($400 in the case of a joint petition). No limit exists as to the total value of goods that may be exempted pursuant to the provision, thus allowing debtors to "stack" exemptions to maximize the total value of the exemption.

Third, the hearings brought out problems with regard to the so-called wild card exemption. Section 522(d)(1) of the Code provides that a debtor may exempt an interest, not to exceed $7,500 in value, in real property ($15,000 in a joint petition). Section 522(d)(5) provides an additional exemption of $400 plus any unused portion of the real property exemption. If the debtor does not own real property, he may use this wild card to exempt up to an additional $7,000 to $15,000 in any type of property owned. This wild card, which applies in addition to the eleven specific exemptions articulated in the Code, confers an unjustifiable, unnecessary "windfall exemption" upon the debtor in bankruptcy.

The Committee bill corrects these problems by placing an aggregate limit on the value of the exemption with regard to household goods and personal effects (allowing a total exemption of $3000 for these types of property); by requiring individuals filing in joint or consolidated cases to elect either the federal or state exemptions together; and by prohibiting the debtor from utilizing the unused dollar value of the homestead exemption to exempt additional property not explicitly provided for by the section.

F. EXCEPTIONS TO DISCHARGE "LOADING UP"

Excessive debts incurred within a short period prior to the filing of the petition present a special problem: that of "loading up" in contemplation of bankruptcy. A debtor planning to file a petition with the bankruptcy court has a strong economic incentive to incur dischargeable debts for either consumable goods or exempt property. In many instances, the debtor will go on a credit buying spree in contemplation of bankruptcy at a time when the debtor is, in fact, insolvent. Not only does this result in direct losses for the creditors that are the victims of the spree, but it also creates a higher absolute level of debt so that all creditors receive less in liquidation.

During this period of insolvency preceding the filing of the petition, creditors would not extend credit if they knew the true facts. Nevertheless, it is often difficult to prove that such debts are fraudulent.

To correct this problem, the bill reported by the committee creates a rebuttable presumption that any consumer debt incurred within 40 days before the filing of the petition has been incurred under circumstances that would make the debt nondischargeable. This has the effect of shifting the burden to the debtor to demonstrate that the debt was not incurred in contemplation of discharge in bankruptcy. The committee believes that this provision, coupled with the modification of the standard applicable to awards of attorney's fees in proceedings to challenge dischargeability under S. 523—discussed below—will be sufficient to discourage this practice and provide an effective mechanism for remedial action. The committee intends that only that portion of a debt which is incurred within the 40-day time period shall be subject to the presumption.

G. ATTORNEY FEES; DETERMINATION OF DISCHARGEABILITY OF A CONSUMER DEBT

The original congressional intent in the drafting of S. 523(d) of the existing Bankruptcy Code was to discourage frivolous objections to discharge of consumer debts, but not to discourage well-founded objections by honest creditors. The language of the subsection, however, makes the award of the debtor's costs and attorney fees virtually mandatory in an unsuccessful challenge of a consumer debt. It has been interpreted as requiring the award of fees and costs even when the creditor acted in good faith. CF., In Re *Majewski*, 7 B.R. 904 (Bk. D. Conn. 1981). The net effect of this provision has been to preclude creditors from objecting to discharge of any consumer debt unless they are certain that the court will sustain the objection.

The mandatory and one-sided nature of this provision goes far beyond what is necessary to deter frivololus objections, and, in fact, has impaired the bankruptcy courts' opportunity and ability to exercise the broad equity powers granted to them by § 105(a) of the Code.

The committee, after due consideration, has concluded that amendment of this provision to allow costs and attorney fees to be awarded to the debtor only if the court finds that the proceeding was not brought in good faith would be a significant benefit to the courts in their effort to insure that the only debts that are discharged are those for which discharge is permitted under the Code. This change would cure the "over-kill" inherent in the present section, while preserving an effective bar to frivolous objections.

H. EFFECTS OF DISCHARGE ON SURVIVING LIENS

Historically, security interests and liens remain enforceable after bankruptcy unless the bankruptcy court has taken some action to affect or invalidate the creditor's interest. In some situations, however, the bankruptcy court will take no action with regard to property which is subject to security interests or liens. Although the Code appears to contemplate that the debtor will surrender such property to the trustee, who will then abandon the property or sell it, this frequently does not occur. Instead, the debtor will often simply retain the property, and continue making payments to the creditor. In other cases, the debtor

may have made an agreement to redeem the property or reaffirm the debt according to a schedule, and subsequently defaulted on the payments.

In such situations, witnesses have indicated, it is unclear whether or not the injunction specified in section 524(a)(2) prevents a creditor from taking postdischarge action against the debtor to recover the collateral, and requires creditors to obtain postdischarge relief from the court. The committee bill would clarify this matter by statutory declaration that creditors need not obtain court authorization to enforce liens which have not been avoided in bankruptcy and thus remain valid and enforceable.

I. REAFFIRMATION OF DEBTS

The Bankruptcy Reform Act of 1978 imposed significant procedural limitations on the debtor's ability to reaffirm debts that would otherwise be discharged in bankruptcy. All creditors—especially credit unions (which are democratically owned and controlled consumer financial organizations)—have experienced an unprecedented decrease in the number of reaffirmations made by borrowers in bankruptcy. As a consequence, increased losses must be borne by the consumers who repay their debts as well as the consumer saver. Industry figures for credit unions alone indicate that reaffirmation rates on both secured and unsecured loans, which ran as high as 70 percent before the new code, have remained around 10 percent since adoption of the 1978 Bankruptcy Reform Act.

Present practice under the Bankruptcy Reform Act

The code now requires the debtor to appear in court at the discharge hearing and have any reaffirmation approved by the bankruptcy judge. The court may approve a reaffirmation only if the agreement is made before the granting of the discharge; if it has not been rescinded within 30 days of becoming enforceable; and if the court has informed the debtor that reaffirmation is not required, and of the legal consequences of reaffirmation. The court must also find that the agreement does not impose undue hardship on the debtor or a dependent of the debtor and that it is in the best interests of the debtor or entered into in good faith in settlement of litigation or to provide for redemption.

In practice, courts have interpreted these requirements in numerous ways. Some courts refuse to approve any reaffirmation agreement, while others provide a limited review of the fairness of the agreement; and a number approve reaffirmation agreements in mass at the discharge hearing. In almost all cases, the court will not approve a voluntary reaffirmation of an unsecured debt. Therefore, many lenders, but especially credit unions which lend to a large degree on an unsecured basis, have been significantly adversely affected by the provisions of the code dealing with reaffirmation.

Under the 1978 code, the court's intervention and admonition that reaffirmation is not required now comes at the end of the bankruptcy process. This greatly diminishes the impact of the warning and enhances the obligation of the judge to scrutinize each bankruptcy agreement under the rigid reaffirmation requirements of the 1978 Bankruptcy Reform Act. Also, the frequently long delay between the

filing of the petition and the reaffirmation/discharge hearing increases the likelihood that the creditor will realize a loss not intended by the debtor. This is a particularly troublesome result where a voluntary reaffirmation has been made by the debtor and the bankruptcy court, because of its interpretation of the code, refuses to approve the reaffirmation. Testimony of industry spokesmen indicates that credit union members frequently approach the credit union after filing for bankruptcy and enter into voluntary reaffirmation agreements, only to have the court deny the approval required. Many credit unions, frustrated by these denials, no longer even expend the effort necessary to secure reffiarmations under the present system.

Impact of automatic stay on reaffirmations

The committee believes that the automatic stay provided under section 362 of the Bankruptcy Reform Act of 1978 has drastically reduced, if not eliminated, the abusive practices encountered under the pre-1978 bankruptcy law. Creditors can no longer independently contact debtors to encourage them to reaffirm debts because such contact is prohibited by the code.

The proposals placed before the committee to remedy defects in the reaffirmation process would not alter the prohibitions on contact with the debtor. Therefore, the major protection provided under the code to prevent coercive reaffirmation remains intact. Reaffirmations obtained presently that are subsequently denied by a bankruptcy court are, in fact, truly voluntary reaffirmations.

Committee bill

The committee proposal envisions a signed agreement or order between the debtor and the creditor that is filed with the bankruptcy court. The agreement must inevitably be voluntary because contact between the debtor and creditor is otherwise prohibited by the automatic stay. The debtor, therefore, has to initiate the contact with the creditor concerning the preexisting debt. In cases where the debtor is represented by counsel, the debtor's counsel would clearly provide an additional buffer to ill-advised reaffirmations. Also, under the committee proposal, the debtor will receive the admonition not to enter into reaffirmations at the first meeting of creditors. Those warnings will be given by the bankruptcy judge, thus reminding each debtor at an early stage that bankruptcy is a judicial proceeding and that court protection from abuse is always available.

The proposal also provides a 60-day cooling-off period during which time the debtor may rescind the reffiarmation agreement by written notice. This extension of the present 30-day period insures that the debtor has an adequate opportunity to judge the impact of a periodic payment on the "fresh start" provided by the 1978 Bankruptcy Reform Act.

The provision for filing the agreement with the court is designed to, (1) lower the cost to the parties of the transaction, (2) minimize the potential burden on the bankruptcy court, and (3) insure that the court is properly informed of such agreements so that it may exercise its equitable powers to protect the debtor from overreaching creditors. In this respect, the language of the bill makes clear the intent of Congress that such agreements be subject to the exercise of the court's

equitable jurisdiction as amplified in section 105 of the Code. While the purpose of the bill is to abolish the cumbersome "Miranda warning" approach of the 1978 act, the committee nevertheless intends that the Court review will constitute more than a "rubber stamp" of the agreement. The key consideration should be ensuring that the debtor will not suffer an undue hardship by the execution of any reaffirmation agreements. In short, the debtor's fresh start should not be impaired by any such agreements.

It is anticipated that, in the vast majority of cases, the obligations of the court may be adequately discharged by brief inquiries to counsel and the debtor. Where the debtor and the debtor's counsel are in agreement that the execution of the agreement is beneficial to the debtor, the presumption should be in favor of ratification of the agreement.

In all, the new section is designed to encourage the prompt execution and implementation of good faith reaffirmation agreements by eliminating the cumbersome and unnecessary prior approval procedures which inhibited debtors and creditors from consummating mutually acceptable debt retirement arrangements.

Many debtors feel a special obligation to a certain lender or financial institution, such as a credit union, and desire to repay those debts regardless of their ability to obtain a discharge under the Bankruptcy Code. While the Bankruptcy Reform Act of 1978 has effectively eliminated the abuses encountered in the reaffirmation area under the prior law, it has also eliminated almost all voluntary reaffirmations in many courts.

The committee proposal would again permit voluntary reaffirmations while preserving the major protection in the 1978 law against abuses by not permitting a creditor to initiate contact with the debtor to obtain a reaffirmation. It is the committee's view that the enactment of the 1978 Bankruptcy Reform Code was not designed to eliminate or even substantially restrict truly voluntary reaffirmations between a debtor and a particular creditor; and the fact that the Code has had this effect is a problem which is addressed and corrected by the committee proposal.

J. PREFERENCES

Many witnesses at the hearings expressed dissatisfaction with section 547 of the Code which covers situations in which the trustee in bankruptcy may recover a "preference." Under both the old and the new Codes, a trustee can recover certain prepetition payments to creditors where certain conditions place the payment in the category of a preferential transfer.

The new Code made two major changes to the provision on preferences that were criticized at the hearings. First, the new Code creates a presumption that the debtor is insolvent for a period of 90 days before the filing of a petition. Insolvency at the time of the payment is one of the conditions a trustee must demonstrate to recover a payment made to a creditor. The presumption was added to relieve the trustee of a difficult burden of proof. Because books or records of a debtor are generally in less than perfect condition, it was often difficult under the old law for the trustee to demonstrate conclusively that the debtor was insolvent.

Creditors taking routine payments on installment debts in good faith, believing the debtor to be solvent, have been faced with the same difficult burden that was previously placed on the trustee. Witnesses felt that by creating a presumption that one element of a preference was satisfied, Congress effectively eliminated that element. It was noted also that, in many chapter 11 reorganizations, the presumption may be inaccurate.

Second, the witnesses criticized the change in the new code which eliminated the requirement that the creditor have reasonable cause to believe that the debtor was insolvent at the time of transfer as a condition to the trustee's recovery of a prepetition payment. Many instances were reported in which payments received in good faith by creditors were the subject of recovery actions. In consumer cases, creditors were being required to return payments received from consumers who were completely current in their obligations to the creditor at the time of the petitions.

The committee recognizes the severe problems that have arisen with preferences, and feels that the burden has been shifted too far and now unfairly discriminates against the good faith creditor. This shift of the burden might be justified if the evidence suggested that the recovery of preference items resulted in significant increases of distributions from the estate. However, for the most part, the administrative expense of these collections, particularly in individual proceedings, results in very little being distributed to creditors.

The bill does not eliminate the presumption of insolvency. However, it does require that the creditor must have had reasonable cause to believe that the debtor was insolvent at the time of transfer before a preference can be established. The committee feels that this represents a better balance between the burden placed on creditors and trustees. The committee does not pass final judgment on the need for the presumption of insolvency, but feels that the code can benefit from a period of experience with the changes contemplated in S. 2000 before that question is finally determined.[7]

K. REDEMPTION OF EXEMPT PROPERTY SUBJECT TO NONPURCHASE MONEY SECURITY INTERESTS

Section 522(f)(2) of the Code invalidates nonpossessory, nonpurchase money security interests in property which is exempt and which

[7] Not all unintended effects have been the result of the Code itself; some have resulted from erroneous interpretations of the Code. An interesting example of this brought to the committee's attention is the case of *Twist Cap. Inc.* v. *Southeast Bank of Tampa*, 1 B.R. 284 (D. Fla. 1979), in which the court granted a temporary restraining order prohibiting payment under a letter of credit which the debtor had obtained for the benefit of a creditor.

This case raised the questions of (1) whether a letter of credit (or in some transactions a guarantee by an insurance company) is property of the bankruptcy estate and (2) whether the fact that the guarantor is secured while the creditor is not makes the payment a preference.

The first issue, regarding property of the debtor, was resolved in the manner contemplated by Congress in the case of *In re Marine Distributors, Inc.* 522 F. 2d 791 (9th Cir. 1975) which determined that a letter of credit is not property of the estate.

The second question has been more recently resolved in the case of *In re Hart Ski Mfg. Co., Inc.*, Bankruptcy No. 3–8–200, Adv. Op./No. 80–45, (unreported memorandum decision of Judge Dim), holding that the transfer of the debtor's property occurred when the guarantees were issued and the guarantor received the right to collateralize its obligation under the guarantees, and not when payment on the guarantee occurred. For that reason, no preference occurs when the guarantor pays the unsecured obligation of the debtor under its secured letter of credit as would have occurred in *Twist Cap.* Since a payment under the letter of credit is not property of the estate nor a preferential payment, the court should grant no injunctive relief—particularly a temporary restraining order—because of the timeliness expectations of the beneficiary of the letter of credit or guarantee.

consists of household goods and personal articles, tools of the trade, and professionally prescribed health aids. This provision was based on the view that such property often had a high replacement cost for the debtor and might aid his fresh start, while it also had a low resale value to the creditor. Thus, invalidating the creditor's security interest seemed to offer substantial benefits at little cost.

Experience under the Code has shown that the invalidation of nonpurchase money security interests in such property has had several significant and detrimental effects on both consumers and creditors. First, consumers who previously qualified for credit only because they could post security in the form of household goods or tools of the trade, now are being denied credit altogether. Moreover, creditors who previously extended credit to such persons have withdrawn from these segments of the consumer credit market, thus decreasing the availability of consumer credit. (See statement of Robert Evans before the Subcommittee on Courts, Oct. 29, 1981 hearings.) This result contradicts the strong congressional policies in favor of making credit more widely available to all segments of the population. Second, creditors often have insisted on new forms of security or protection which would not be invalidated under section 522(f)(2): for example, creditors may seek second mortgages, cosigners, and security posted by cosigners. Finally, the committee's attention was directed to cases where the debtor borrowed against equity in items of property of this type having high market value (such as antique furniture). In such cases, the effect of the new Code is to impair the creditor's security in property which has significant economic value and which does not fall within the high replacement/low resale rationale of section 522(f)(2). (See Rice, Wiese, Landers testimony, p. 61, April 1981 hearings.)

It is possible to preserve the debtor's fresh start by allowing him to retain these articles, and still avoid the harsh expedient of totally invalidating the security interest. Accordingly, the committee believes that the debtor should have an absolute right to retain such property but, at the same time, the creditor's security interest should not be invalidated. Instead, the consumer should be permitted to redeem the property in installments over a sufficiently long period to avoid undue hardship for the debtor. To implement these changes, section 8(c) of S. 2000 would delete section 522(f)(2) of the Code, and section 13 would permit the debtor to retain exempt household goods, tools of the trade, and health aids, and to redeem them in installments over a period of 5 years. It thereby serves the purpose sought by the draftsmen of section 522(f)(2) without depriving the debtor of the opportunity to use such property as security, or punishing the creditor who seeks reasonable collateral protection.

Section 13 of S. 2000 also provides important protection for a debtor who may need otherwise nonexempt property to establish his or her fresh start but who may not be able to satisfy an outstanding lien, even under the liberal redemption provisions of the bill. Under the bill, the court can avoid any lien upon such property if the court finds that the debtor has no reasonable ability to satisfy the redemption obligation, and that the enforcement of the lien would impose undue hardship.

L. AUTOMATIC RELIEF FROM STAY ON CODEBTOR OBLIGATION IN CHAPTER 13

Section 1301 stays the creditor's efforts to collect a consumer debt from codebtors, cosigners or guarantors upon the filing of a chapter 13 petition. The creditor is entitled to have the stay lifted to the extent the plan does not propose to pay the debt or to the extent that the codebtor, cosigner or guarantor received consideration for the debt. The lifting of the stay on those grounds, however, is not automatic and requires a request before the court and notice and a hearing. Creditors maintain that the significant costs and expenses which are involved in this procedure can be eliminated without undue burden for the debtor or codebtor by requiring a 10-day advance notice to the debtor and the codebtor after which time the stay, absent an objection, would be lifted. The committee believes that this constitutes a reasonable proposal which will help minimize unnecessary expenditures of time and financial resources by the courts and creditors alike. If an objection to the proposed action against the codebtor, cosigner or guarantor is lodged by the debtor, or codebtor, notice and hearing as provided for in present law will precede any collection action.

M. COMMENCEMENT OF PAYMENTS, CHAPTER 13

Under present law, payments under a chapter 13 plan frequently do not begin until the plan is confirmed. This sometimes takes several months or longer. Unfortunately, when the payments do not begin promptly, the debtor becomes accustomed to living on money that will not be available once the plan becomes operational; and it may be very difficult for the debtor to scale down expenditures once the plan begins. Indeed, chapter 13 trustees report that there is much greater incidence of compliance with the plan when payments begin promptly, and prompt commencement is required in some districts by local court rules. Moreover, the period between the filing of a plan and confirmation provides a good test of whether the debtor will be able to carry out the plan, or whether some modification is necessary.

In the Rice testimony it was pointed out that:

> In a number of districts the debtors are expected to, and do, commence making payments to the trustee immediately upon the filing of the case; and we suggest that adequate authority for such procedure is presently in the statute. However, the language contained in section 1325(b) has led some courts to conclude that the debtor *should not* make payments immediately upon filing of the case. (Emphasis added.)

There appears to be broad agreement that payments to the trustee should commence immediately upon filing of the plan.

N. TREATMENT OF NONDISCHARGEABLE DEBTS AND COSIGNED DEBTS IN CHAPTER 13 PROCEEDINGS

1. Nondischargeable debts

Section 523(a) of the Bankruptcy Reform Act specifies a number of claims which are not dischargeable in bankruptcy. This means that the

debtor remains obligated to pay such claims, and they may be collected from post-petition earnings and property where proceedings are instituted under the provisions of chapter 7.

In chapter 13, however, all of these claims are dischargeable except those for alimony and child support claims (see section 1328(a)(2)), and they are dischargeable even if the debtor proposes to pay little or nothing in satisfaction of the claims; for, although section 1325(a)(4) requires unsecured creditors to receive as much in chapter 13 as they would in chapter 7, this has been interpreted by courts to allow chapter 13 claimants only as much as they would receive from a liquidation of the debtor's present property. Cf., *In re Marlow*, 3 B.R. 305 (Bk., D.N.D Ill. 1980); *In re Jenkins*, 6 BCD 378 (Bk., D. Colo. 1980); *In re Thorson*, 6 B.R. 678 (Bk., D.S.D. 1980). Such a standard does not, of course, consider the fact that creditors with nondischargeable claims have access to postpetition earnings and property, and in the committee's view it is inadequate to encourage satisfaction of these important claims. As witnesses emphasized, the provisions quoted above, as presently written, effectively undermine section 523(a) in several important respects. First, they permit persons with nondischargeable claims effectively to avoid section 523(a) by filings a chapter 13 plan providing for small payments to creditors with nondischargeable claims. *In re Marlow*, *supra* (1 percent); *In re Jenkins*, *supra* ($1). Second, they encourage debtors to propose the smallest possible chapter 13 payout, for, under chapter 13, if a debtor proposes a 10 percent payout and completes the plan, most of the nondischargeable debts are fully discharged. Anomalously, if the debtor proposes a 75-percent plan payment of nondischargeable debts and receives a hardship discharge under section 1326(b) after paying 25 percent of the claim, the claim is not discharged. Under these circumstances, debtors with nondischargeable claims only logically propose the lowest payout to assure completion of the plan, and dischargeability of the otherwise nondischargeable claims is the result. Third, because nondischargeable claims are not allowed special treatment in chapter 13, section 1322(b) probably forbids the creditor with a nondischargeable claim from being treated differently from other unsecured creditors.

The committee bill corrects these problems by (1) statutorily encouraging satisfaction of S. 523(a) debts in chapter 13, (2) conforming the treatment of such debts provided for in chapter 13 to that accorded them in chapter 7, and (3) allowing the chapter 13 plan to discriminate between section 523(a) debts and other debts scheduled so as to facilitate their integration into a workable plan.

The proposed bill accomplishes these objectives through four principal amendments. First, it contains a statutory recognition of the desire of the Congress that nondischargeable debts be retired in chapter 13 proceedings where possible by explicitly providing for their inclusion in a wage-earner plan. This is accomplished by amendment to section 1322(a), which sets forth the authorized contents of a plan. Second, it amends section 1322(b) to allow a separate scheduling of section 523(a) debts in the plan without invoking the antidiscrimination provisions of that section. Third, it amends section 1328(a)(2) so as to prohibit the discharge of unpaid section 523(a) debts after completion of a plan. Finally, and as an incentive to scheduling of

section 523(a) debts in a chapter 13 proceedings, the bill would allow hardship discharge of section 523(a) debts that were proposed to be paid as part of an aborted plan (this being accomplished by amendment to section 1328(c)(2)).

2. Cosigned debts

A number of cases have considered whether claims involving co-debtors may be classified separately from other claims. Thus far, the majority of cases have refused to permit such classification on the ground that co-debtor claims are no different than other claims. See, for example, *In re Utter*, 3 B.R. 369 (Bk. W.D.N.Y. 1980); *In re Montano*, 4 B.R. 535 (Bk. D.D.C. 1980).

Although there may be no theoretical differences between codebtor claims and others, there are important practical differences. Often, the codebtor will be a relative or friend, and the debtor feels compelled to pay the claim. If the debtor is going to pay the debt anyway, it is important that this fact be considered in determining the feasibility of the plan. Sometimes, the codebtor will have posted collateral, and the debtor will feel obligated to make the payment to avoid respossession of the collateral. In still other cases, the codebtor cannot make the payment, and the effect of nonpayment will be to trigger a chapter 7 or chapter 13 petition by the codebtor, which may have a ripple effect on other parties as well. For these reasons, separate classification is often practically necessary.

Courts under both the present act and the former Code have emphasized that plans must be realistic. For example, courts have refused to conform plans which the debtor could not possibly perform; have insisted on realistic estimates of expenditures; and have considered debts which the debtor proposes to pay outside the plan in determining feasibility. See, for example, *In re Washington*, 6 BCD 1094 (Bk., E.D. Va. 1980). This approach is eminently sensible: No purpose is served by confirming a plan which the debtor cannot perform. If, as a practical matter, the debtor is going to pay the codebtor claim, he should be permitted to separately classify it in chapter 13. A result which emphasizes purity in classifying claims does so at the price of a realistic plan. Neither debtors nor creditors benefit from such a rigid approach, and the committee has determined that statutory authority to separately schedule such debts will contribute to the success of plans contemplating repayment of same. Accordingly, this authority is provided for in the proposed bill by amendment to section 1322(b)(1).

O. LENGTH OF CHAPTER 13 PLAN

The question of length of a plan is also cause for concern. In the past decade, the financial community has witnessed an increasing willingness of consumers to incure longer term debt for transactions other than first mortgages on residential property. For example, the maturities of new car loans often are 4 to 5 years, and the maturities on credit sales of appliances often are 3 years.[8] Many consumers have made second mortgage loans using the equity in their homes, and ma-

[8] According to Federal Reserve Board data, new auto contracts in November 1980, written by finance companies averaged 44.8 months. Mobile Home Loan contracts averaged 137.2 months and other goods, 24.5 months.

turities usually extend over 5 to 10 years or more. A consumer who files a chapter 13 petition is, in effect, asking that debt which essentially is short term debt be converted into longer term debt. Given the consumer's willingness to incur relatively long maturities for traditional consumer loans, it may be reasonable to allow a longer maturity when short term debt is being converted into longer term debt than present chapter 13 practice allows.

Convincing testimony was offered by Claude Rice, Esq., at the October 29, 1981 hearings held by the Subcommittee on Courts, which indicated that the present 3-year standard for confirmation—first adopted in 1938—may be working substantial hardship on both debtors and creditors alike. Mr. Rice, a chapter 13 trustee for over 25 years and an executive of a company which provides data processing services to courts, attorneys, and trustees in the processing of bankruptcy cases particularly chapter 13 cases provided the subcommittee with computer printouts summarizing the results of over 138,000 cases during the 20-year period from 1960–1981. He observed that:

> A mandatory limit is a restriction on the debtor's ability to propose a feasible plan commensurate with his ability to pay. The short time limit is not a benefit to the debtor. It merely forces well intentioned debtors to attempt a payment schedule greater than they are able to maintain.
>
> The statistics which we have maintained have consistently indicated for over 15 years that those debtors whose cases are dismissed or converted to liquidation cases have attempted to pay from $5 to $10 per week more than those debtors whose cases are successfully completed.
>
> In this connection, we attach a series of reports and charts which display the effect of limiting the length of the debtor's plan. Briefly stated, an extension of the period of time which the plan is allowed to extend can substantially reduce the debtor's monthly payments and improve the net return to creditors.[9]

In a second summary of 35,000 cases closed in 1980–1981, Mr. Rice observed:

> Analysis of this data has always indicated that those debtors who were unable to complete their plans, those debtors whose plans were dismissed or converted to liquidation cases, were those debtors whose proposed payments were 5 to 20 percent greater than the payments proposed by those debtors who completed their plans. . . . In both of these summaries it should be observed that the debtors whose plans were successfully completed averaged more than 36 months and always provided for smaller monthly payments than those cases which were dismissed on converted to liquidation cases.[10]

Thus, from the debtor's standpoint, a plan permitting lower payments, realistically commensurate with disposable income and made for a longer period of time, is more likely to succeed.

[9] Rice testimony, Oct. 29, 1981, Ser. J–97–11, pt. 2, p. 44.
[10] Rice testimony, Ser. J–97–11, pt. 2, p. 51.

Likewise, there are serious limitations imposed by the 3-year limit on the ability of debtors to pay unsecured debt. According to the analysis of the 35,000 cases provided by Mr. Rice, trustee's fees and expenses, priority items, and secured claims account for about 65 percent of the total funds available in a 36-month plan, leaving less than 35 percent available for unsecured creditors. If the actual funds available in a 36-month plan were made available at the same rate for longer periods then, according to the analysis, approximately 77 percent of unsecured debt would be paid in 48 months, and 100 percent would be paid in 55 months.

Clearly, the chapter 13 debtor's priority obligations are frequently so great that—on the average—they crowd out the repayment of all but a small portion of the unsecured debt. The question arises whether, taking into account the relatively high proportion of unsecured debts found in chapter 13 proceedings, equitable treatment is being accorded unsecured debtors. If it is not, it may well result in a profound and adverse effect on the availability of unsecured consumer credit. As Mr. Rice concludes:

> It is obvious from examining these charts that the length of time for which the debtor's plan may be proposed has a profound impact both on the amount of money that the debtor needs each pay day to meet the requirements of a plan or the amount of money which creditors will be paid or both. * * *
>
> It should be noted that the statute presently requires the secured creditors to retain their liens and be paid under the plan amounts not less than the value of their security. It is the unsecured creditors whose interest can be adversely affected by a chapter 13 plan. This is the group that represents the merchants, bankers, credit cards, doctors, and other small business interests. These claims represent only 51 percent of the dollars claimed but over 73 percent of the number of creditors involved.[11]

The committee believes that lengthening the standard plan term from 3 to 5 years will not only enhance debt recovery in chapter 13 cases, but will also result in lower failure rates for debtors who desire to make a good-faith effort to repay their obligations. The committee proposal will, at the same time, permit a debtor who desires to expedite the retirement of debts to do so by allowing termination of the plan earlier than 5 years where a reasonable portion of unsecured claims have been satisfied.

P. STANDARD FOR CONFIRMING CHAPTER 13 PLANS

In theory, chapter 13 is consistent with the basic premise upon which consumer credit is granted: The debtor proposes a plan to pay his debts over a period of time and, almost always, out of future income. Chapter 13 proceedings thus look to future income—the very asset upon which credit is granted in the first place—as a source for repayment of debt. The committee believes that chapter 13 should therefore be consistent with the income-based approach to consumer credit.

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[11] Rice testimony, Ibid, p. 54.

Unfortunately, the promise of chapter 13 has only been partly realized. The present chapter 13 provisions do not articulate any meaningful standards for determining what portion of the debtor's income should be devoted to the plan, and for how long the plan should last. The absence of such meaningful standards has had an important impact on the ability of creditors to obtain meaningful recoveries in chapter 13 cases.

Income devoted to the plan

Chapter 13 does not contain any standard which specifies how much of the debtor's future income should be devoted to the plan. The only provisions which bear on this issue are found in section 1325(a)(4), which requires that creditors receive at least as much in a chapter 13 case as they would receive in a chapter 7 liquidation, and section 1325(a)(3), which requires the plan to be "proposed in good faith."

In both theory and practice, the requirement that creditors in a chapter 13 case receive at least as much as they would receive in a chapter 7 liquidation, is not a meaningful standard. In theory, the liquidation standard necessarily looks to present assets as a source for paying debts. The fact that debts cannot be paid out of assets has no bearing upon the extent to which they can be paid out of future income. In practice, chapter 13 creditors usually would receive little or nothing in a chapter 7 case because the debtor has little or no nonexempt property for distribution. Indeed, some courts have turned this standard against creditors, and used it as the basis for confirming chapter 13 plans providing for no payments or nominal payments to creditors. These courts reason that since creditors would have received nothing in a chapter 7 case, they have little cause to complain if they receive nominal payments under a chapter 13 plan.[12]

The good faith standard provides little further protection. The standard is unduly vague, and there is no legislative history, or supportive provisions in chapter 13, which would help to give it content. Indeed, it is not even clear whether good faith, as contemplated in the statute requires some objectively determined portion of the debtor's future income to be devoted to the plan, or whether subjective good faith (a pure heart) is all that is necessary.[13]

The Code does not provide any target for the portion of debt which should be repaid, nor does the Code even provide that repayment of debt should take precedence over expenses for non-necessary or luxury items.[14]

Given such vague and uncertain standards, it is not surprising to find widely different approaches among bankruptcy courts. Some courts have set a benchmark test of a 70-percent payment, while others have specifically rejected guidelines.[15] Some courts reportedly

[12] See *In re Stollenwerck*, 8 B.R. 297 (M.D. Ala. 1981); *In re Cloutier*, 3 B.R. 584 (Bk. D. Colo. 1980).

[13] See *In re Stollenwerck*, supra (debtor's proposal to pay one-half of excess disposable income is in good faith); *In re Sudduth*, 9 B.R. 405, 407 (Bk. N.D. Ga. 1981) (allegations that payments are insignificant in light of available disposable income are not "material to a determination of . . . good faith"). After an exhaustive examination of the meaning of good faith, Judge Norton concluded that it simply meant "honesty of purpose" and "full and complete disclosure." On the other hand, good faith did not have a quantitative meaning, nor did it require the debtor's best effort. *In re Wiggles*, 7 B.R. 373, 375–80 (Bk. N.D. Ga. 1980).

[14] See *In re Stollenwerck, supra* (out of excess disposable income of $400 per month, plan proposed to pay $200 per month; no payments to unsecured creditors).

[15] See *In re Raburn*, 4 B.R. 624 (Bk. M.D. Ga. 1980).

press debtors' attorneys for plans paying 50–100 percent of claims, while others intimate that attorneys for debtors who propose to pay more than 10–25 percent have not provided effective representation to their clients. Some courts seem to consider the debtor's ability to pay as crucial, whereas others have refused to confirm low payment plans even when they represent the debtor's best effort.[16] Throughout the country, courts regularly are confirming plans which provide for payment of 10–25 percent of claims, and occasionally nothing at all.[17]

A chapter 13 proceeding involves substantial benefits to the debtor who is able to retain his property, avoid most nondischargeable debts, and cram down debts of secured creditors. The *quid pro quo* for such benefits would seem to be a substantial effort by the debtor to pay his debts. Of course, the first criterion in such cases must be the debtor's obligations to support himself and his family. But beyond that, it is necessary to have a definite standard delineating how much of the debtor's future income should be committed to the plan.

Chapter 13 relief is essentially equitable, and contemplates a substantial effort by the debtor to pay his debts. Such an effort, by definition, may require some sacrifices by the debtor, and some alteration in prepetition consumption levels. Thus, the debtor might reasonably be required to devote to the plan that portion of his income which is not necessary for support of the debtor and his family. The courts may be expected to determine norms for such support, and Labor Department cost of living figures may provide some help. This approach will also permit plans to be confirmed where the debtor does make a substantial effort to pay his debts, even though the payment itself is not substantial.

V. Summary of the Bill and Sectional Analysis

A. SUMMARY OF KEY PROVISIONS OF S. 2000

1. Requires the Bankruptcy Court to consider future income of the debtor in determining whether or not the debtor qualifies for straight bankruptcy. If the debtor can pay a reasonable portion of nonmortgage debts off in a chapter 13 proceeding out of his discretionary income (income available to him after deduction of living expenses for himself and his dependents), he would have to proceed in chapter 13 to obtain bankruptcy relief. If later hardship made it impossible for the debtor to continue in chapter 13, he could obtain discharge of debts in bankruptcy.

   a. The determination of future earnings potential will be based upon information regarding expected income supplied by the debtor. The income considered by the court must be from a source supplying income to the debtor at the time of the filing of a petition (such as debtor's present job) or from a source that is certain to supply income (such as trust funds) within 12 months of the filing of the petition.

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[16] *In re Murallo*, 4 B.R. 666 (Bk. D. Conn. 1980) (10 percent plan not adequate regardless of debtor's financial resources); *In re Hall*, 4 B.R. 341 (Bk. E.D. Va. 1980) (6 percent not adequate, even though it is significant in light of debtors' monthly income).

[17] See *In re Harper*, 3 CCH–Bankr. L. Rep. Para. 68.018 (Bk. N.D. Ga. 1981) (1 percent); *In re Cloutier*, supra (0 percent); *In re Harland*, 3 B.R. 597 (Bk. D. Nebr. 1980) (0 percent); *In re Johnson*, 6 B.R. 34 (Bk. N.D. N.D. Ill. 1980) (1 percent); *In re Carter*, 9 B.R. 140 (Bk. N.D. Ga. 1981) (0 percent); *In re Celeste*, 9 B.R. 392 (Bk. N.D. Ohio 1981) (8 percent); *In re Walsey*, 7 B.R. 779 (Bk. N.D. Ga. 1980) (10 percent).

b. The court may exempt any debtor from the application of the future incomes test where that debtor can how that its application to him would result in hardship.

c. Any debtor who could pay no more than 25 percent of his debts off in a deferred payment plan under chapter 13 would qualify for chapter 7 straight bankruptcy. (Report language.)

d. Credits who harass debtors with frivolous challenges to petitions seeking chapter 7 relief can be assessed court costs and attorney's fees incurred by the debtor in responding to such challenges.

2. Debts incurred within 40 days of the filing of the petition are presumed to be nondischargeable (that is, incurred in contemplation of filing bankruptcy). The presumption is rebuttable by the debtor. The purpose is to inhibit the practice of loading up in a credit buying spree prior to filing bankruptcy.

3. Reaffirmation agreement procedures are simplified so as to encourage mutually acceptable arrangements worked out between creditors and debtors to provide for full or partial payment of debts otherwise dischargeable in bankruptcy. Courts will retain the power to review such agreements and nullify them where the debtor may have acted unwisely. Also, the debtors retain the power to cancel the agreement any time within 60 days of its filing with the court—an expansion of the cooling off period provided for in present law of 30 days. If the debtor rescinds, or the court nullifies the agreement, moneys paid to creditors would be returned to debtors.

4. Trustees will no longer be able to void payments made by a debtor to his creditors in the ordinary course of business prior to the filing of bankruptcy (such as installment debt payments) unless it can be shown that the creditor had reasonable cause to believe that a bankruptcy was imminent.

(Presently, the trustee can void any such payment made within 90 days of the filing of the bankruptcy whether or not the creditor knew the debtor was insolvent. This amendment reinstates the knowledge requirement that was contained in the Bankruptcy Act of 1938.)

5. Amends section 522 of the Code to require individuals filing in joint or consolidated cases to elect either the Federal or State exemptions together, and places an aggregate limit on the value of the exemption of $3,000. The bill would also prohibit the debtor from utilizing the unused dollar value of any exemption to exempt additional property not provided for by the section.

6. Repeals present provisions of the law which allow debtors to invalidate nonpossessory, nonpurchase money security interests in household goods, wearing apparel, tools of the debtor's trade and health aids.

As compensation, allows debtor to pay outstanding debts secured by such items in a deferred payment plan extending over 5 years. The debtor would only have to make payment equal in amount to the actual value of the goods in question at the time of the bankruptcy. In hardship cases, court can void lien.

7. Requires commencement of payments under a chapter 13 plan within 30 days of the filing of the plan with the court. This allows payments to be made to the trustee between the time the plan is filed and the time it is confirmed, which can be several months. If no plan is ultimately confirmed, the payments are returned to the debtor.

8. Conforms the treatment of nondischargeable debts in chapter 13 to that accorded in chapter 7. Under present law, a debtor can obtain a discharge of otherwise nondischargeable debts at the conclusion of a chapter 13 plan even though he may pay only 1 percent on those debts in the plan. Only exceptions to this are alimony and child support debts; others, such as taxes, debts incurred by fraud, fines and penalties, and similar items, can be discharged.

a. The bill would still allow hardship discharge of these debts where the debtor has made a good faith effort to pay in a chapter 13 plan, but cannot complete the plan due to unforeseen circumstances. This is an improvement on present law, which does not allow hardship discharge of nondischargeable debts.

B. SECTIONAL ANALYSIS

Section 1

Title.

Section 2

Amendment to section 105(a), designed to clarify the scope of the disciplinary powers of the bankruptcy courts, and provide explicit title 11 authorization for the imposition of contempt penalties.

Section 3

(a) This section establishes a threshold eligibility test for individuals seeking to obtain liquidation relief under chapter 7 of the Bankruptcy Code. Under present law, to be a bankruptcy debtor, a person need not have liabilities exceeding assets; nor does a person have to be unable to repay debts as they come due. This situation creates the potential for solvent individuals to take unfair advantage of the special provisions of the code that limit actions by creditors or permit alterations in lease and loan agreements that would not be permitted outside the bankruptcy court. The new subparagraph (b) (1) in section 109, when read in conjunction with the new subparagraph (c) of such section, would prohibit an individual from obtaining relief under chapter 7 where that individual can pay "a reasonable portion of his debts out of anticipated future income." Under the new subsection (c) (1), the term "reasonable portion of debts" is defined as a substantial percentage of the total, outstanding debt (excluding debts secured

by a first mortgage or deed of trust on the debtor's principal residence) reflected upon the schedule of liabilities filed by the debtor pursuant to section 521(a)(2) of the code. The term "anticipated future income" is defined therein as income which the debtor has a reasonable expectation of receiving from sources providing income at the time of filing, or which will provide income commencing upon a date certain within 12 months following the filing of the petition.

As already noted, consumer credit is, more often than not, extended on the basis of the individual's anticipated future income and the likelihood that it will continue. Creditors thus assume the risk that the consumer's future income will not be adequate to repay the credit extended. However, they should not have to assume the further risk that a consumer who is able to pay all or part of his debts out of future income will choose not to do so, as is now permitted by the code. This provision, therefore, makes bankruptcy relief consistent with the transactional assumptions underlying the grant of consumer credit.

The section does not exclude any person from filing a bankruptcy case. Instead, the petitioner must initially determine whether he can reasonably expect to pay his debts; then, the burden is placed on parties in interest (that is, the trustee or creditors) to move to dismiss the case on the ground that the debtor can be expected to pay a reasonable portion of his debts out of future income. Such a motion must be made prior to the conclusion of the section 341 meeting of creditors (under the amendment to section 305), and this relatively short time period assures that administration of the case will not have proceeded very far. Moreover, placing the burden on creditors assures that such motions will only be made in cases where the debtor has substantial ability to pay debts. Experience under the present code has shown beyond doubt that the transaction cost of seeking any form of relief in the bankruptcy court is an extremely strong deterrent to creditor action, and that creditors will act only where the expected benefits strongly outweigh the costs of the proceeding. In practice, then, creditors would only file a motion to dismiss in the case of a debtor whose debt-paying ability is sufficient to justify the costs of the proceeding. A further protection against creditor over-reaching with respect to the threshold is the grant of authority contained in the revised sections 105(a) and 305 (subparagraph (b) thereof) which will allow the court to award attorney's fees and costs to the debtor if it is determined that a challenge was not filed or pursued in good faith.

(b) The purpose of the provision is to limit chapter 7 relief to those individual debtors who are unable to satisfy any substantial percentage of their nonmortgage debts, or who face hardship circumstances of a type as to make considerations of future earnings capabilities irrelevant. The operative language in the new subsection (c)(1), "reasonable portion of debts," is defined in accordance with this intent. The determination of what a substantial percentage of the debtor's nonmortgage debt liability is in a given case will, of course, vary depending on the court's evaluation of the totality of the debtor's financial circumstances.

The court is expected to consider the amount and regularity of the debtor's after-tax income; the expenditures he must make for the support of himself and his dependents; the likelihood of increased future

income and expenses (pursuant to subsection (c)(1)(b)(ii)); the need for a cushion for unexpected expenses; and the obligations the debtor faces for debt repayment, in determining whether the debtor can pay a "substantial percentage" in the individual case. It is the intent of Congress, embodied in subsection (c)(1)(b), that the only income capability that the court will consider will be that which is reasonably certain to flow from sources providing actual income at the time of filing of the petition, or by a date certain within the period of time specified in (c)(1)(b)(ii), such as vested pension plans or trust fund arrangements. Subsection (c)(2) provides for the amelioration of the threshold eligibility requirement in those cases where exigent circumstances, such as unusually burdensome medical expenses, dictate a finding that undue hardship would be placed upon the debtor by the application of subsection (c)(1).

In deciding whether the debtor can pay a reasonable portion of his debts out of future income, the court will have access to a number of sources of information. The debtor will submit his schedules of assets and liabilities, as well as a statement of expected income and expenses for the 12 month period following the filing of the petition, pursuant to the provisions of section 521. The court will have opportunity to examine the debtor concerning the debtor's anticipated future income, if any, and any unusual circumstances surrounding the debtor's financial condition. In addition, parties will present evidence at the hearing on any section 305 motion to dismiss. The totality of this evidence should provide the court with a comprehensive picture of the debtor's financial picture, and enable the court to make a reasoned decision whether the debtor has substantial prospective debt paying ability.

(c) It is intended that the courts will make the determinations required by the provisions of section 109(c)(1) within the parameters of the guidelines set forth below. Upon the consideration of the motion to dismiss filed pursuant to section 305(b), the court shall first calculate the debtor's reasonably anticipatable net income and expenses for the 12-month period following the date of the filing of the petition. Next, the court shall calculate what portion of the debtor's net annual income, if any, is available to the debtor for the satisfaction of debts after the payment of such expenses as are necessary to support the debtor and his dependents. Finally, the court shall then evaluate whether or not, under all the circumstances bearing upon the debtor's financial condition at the time of the filing of the petition, the debtor can be reasonably expected to repay a substantial percentage of his total nonmortgage debts out of the income available to him which is not obligated for the support of himself and his dependents. The court will, of course, be calculating with the assumption that the future earnings projected by the debtor for the 12-month period following the filing of the petition will be available on a continuing basis—unless the evidence elicited at the hearing upon the motion to dismiss indicates otherwise.

In determining what constitutes a "substantial percentage" of nonmortgage debts, the Congress intends that the major consideration shall be the assessment of what percentage of debts could be paid over a 3- to 5-year period if the projected discretionary income available to

the debtor were to be applied to the satisfaction of those debts in a deferred monthly payment plan. Where an individual debtor could clearly retire as much as 75 percent of such debts during that period of time, that debtor would presumably be found to have the ability to pay a reasonable portion of his debts, and would thus not qualify for chapter 7 relief. Conversely, if the debtor could pay no more than 25 percent of his debts during the same period, the debtor clearly does not have substantial debt paying ability and would be eligible for chapter 7 relief.

As to those cases which will fall between these two extremes, the court will, of course, be expected to exercise sound judicial discretion in evaluating the financial circumstances of the debtor and ruling upon a motion to dismiss. Since most debtors who are ultimately denied chapter 7 relief will, in all likelihood, file under chapter 13, there will be ample opportunity for the court to alleviate any hardship that may unexpectedly result from the initial denial of chapter 7 relief through a motion and order of conversion. Nevertheless, the court will be expected, in marginal cases, to resolve any doubts concerning eligibility in favor of the debtor. Key considerations in those cases in the mid-range should be the debtor's employment stability record; the degree of protection enjoyed by the debtor with regard to potential reductions in the work force in the company or industry he is employed in; the security of any future income payments which will emanate from a source other than regular employment; the debtor's medical history, and that of dependents; and any other factor or factors which will have an impact upon the debtor's ability to guarantee the regularity of such future income as the evidence may indicate will be available to him.

(d) There will undoubtedly be an adjustment period for the courts during which the integration of the new principles set forth in this section into existing bankruptcy procedure will cause some uncertainty in eligibility determinations for individual debtors. Experience with other provisions of the code indicates, however, that the responsibilities placed upon the courts by the threshold test can and will be successfully assimilated. For example, the court must presently consider the debtor's ability to repay debts arising from educational loans to determine whether such debts should be discharged under section 523(a)(8). Likewise, section 522(d)(11) of the 1978 act, which granted an exemption for personal injury and wrongful death awards and life insurance benefits, requires a determination of the amount "reasonably necessary for the support of the debtor and any dependent of the debtor." Courts applying the hardship discharge and modification provisions of sections 1328 and 1329 of chapter 13 must resolve comparable kinds of questions. Finally, a number of courts have considered the debtor's ability to repay debts as a factor in determining whether a chapter 13 plan should be confirmed. In short, the proposed standard and process already is a familiar part of bankruptcy jurisprudence.

In the long run, it is believed that the amendments made by this section will reduce the total amount of bankruptcy court litigation. Much present litigation is directed toward reaching the future income of debtors who are likely to have substantial ability to repay prepetition debts. Litigation over dischargeability, redemption, and re-

affirmation are examples. Moreover, at least some exemption litigation is directed toward reaching the assets of persons who have reasonable debt paying ability. If persons who can pay a reasonable portion of their debts out of future income are not permitted to use the liquidation process in the first place, much of this ancillary litigation will be rendered unnecessary.

Section 4

(a) This section, by amendment of section 305(b), requires that any motion to dismiss a case on the ground that the debtor can pay a reasonable portion of his debts out of future income (and thus does not qualify for chapter 7 relief under the provisions of sections 109 (b) (1) and (c) (1)) be filed before the conclusion of the first meeting of creditors held pursuant to section 341(c). It also requires the court to decide the motion only after notice and hearing, and provides that the costs and attorney's fees expended by the debtor in responding to a motion which is not filed or pursued in good faith may be charged to the creditor. Because of the importance of the section 109 determination on bankruptcy administration, it is expected that the motions will be determined promptly.

(b) In considering a debtor's motion for award of costs and fees predicated upon a claim that a section 305 challenge was brought or pursued in bad faith, the court is expected to consider the totality of circumstances surrounding the filing and consideration of the motion to dismiss. Clearly, the element of bad faith is present where a creditor engages in the filing of "form" motions without scrutiny of underlying circumstances of the individual case, or files and pursues a clearly frivolous motion for purposes of harassment, or continues pursuit of a motion which—originally filed in good faith—has been rendered moot by changed circumstances, known to the creditor, which indisputably create hardship upon the debtor of a type sufficient to invoke application of the hardship relief clause incorporated in section 109. In such cases, the court is expected to correct the occasionally errant creditor by the award provided for in this section. In more egregious cases, where a creditor engages in a systematic pattern of bad faith challenges, the court may also invoke its disciplinary authority, codified in section 105, to address such abuses by the use of contempt powers. At the same time, it is the intent of the Congress that creditors should not be discouraged from filing good faith challenges by indiscriminate allowance of costs and fees.

Section 5

The amendment requires the bankruptcy judge to convene—but not necessarily preside over—the section 341(c) meeting of creditors, and directs the court to perform such judicial functions which may be required under this title or necessary to resolve disputes arising at such meetings.

The new provisions recognize that the bankruptcy judge can perform vital judicial functions at the meeting of creditors which should be rendered as early in the bankruptcy proceedings as possible. Disputes over the scope of inquiry of the debtor, and alleged deficiencies in the debtor's petition and schedules, must be resolved by a judge. The debtor may have possession of property subject to secured claims, and

the judge can direct the debtor to return such property, or can resolve questions regarding redemption. This section should be considered with section 521(3) which requires that the debtor file a statement indicating his intended disposition of collateral which is subject to security interests and make provision for such disposition at or before the meeting of creditors. It is intended that disputed matters be resolved early in the administration of the estate and without necessity for separate contested or adversary proceedings. Such proceedings impose an additional cost upon both creditors and debtors, without any corresponding benefit.

This section relates to section 524(d) which requires the bankruptcy judge to inform the debtor of the nature and effect of a discharge and reaffirmation at the hearing provided for by this section.

It is intended that this section will benefit both debtors and creditors by avoiding the need for multiple appearances in bankruptcy cases, and reducing the administrative expense and burden on the judicial system presently imposed by the necessity of holding both the meeting of creditors and separate adversary proceedings to determine issues concerning liens on the debtor's property, as well as separate discharge and reaffirmation hearings. By these changes, first meetings of creditors will have greater substance, and the debtor will be impressed more effectively with a sense of the seriousness of the judicial proceeding he is engaged in.

The court can expeditiously perform its advisory functions at such meetings by addressing groups of debtors *en masse* at the commencement of the call of the section 341 docket. Following that, the court will hold itself available for the hearing of disputed questions at the request of the parties. In this manner, the burden upon the court will be minimized while nevertheless ensuring that the debtor is aware both of the gravity of the proceedings and the supervisory role of the court.

Section 6

(a) This amendment is intended to reduce litigation revolving around valuation of consumer goods which the debtor may seek to redeem pursuant to section 722 or retain pursuant to section 1325(a)(5)(B)(ii).

Consumer goods such as furniture are those acquired for personal, family, or household use. See Bankruptcy Code section 101(7). The expectation of both consumers and creditors is that the consumer will pay for the goods out of future income and not by the proceeds of selling the property. Consumer goods usually decline in value almost immediately following purchase.

When the consumer redeems property pursuant to section 722, or seeks to use it pursuant to section 1325(a)(5)(B)(ii), the consumer is indicating a desire to continue the underlying transaction between the parties. However, there has been much unnecessary expense to creditors and debtors in determining the value of secured property for redemption purposes.

The provisions of the new section specify the preference of the code for use of a resale market standard, with the choice of wholesale or retail measurements of value to be determined by reference to the condition of the property and the debtor's proposed use or disposition

thereof. In either case, the section encourages reference to trade publications as appropriate indicia of the market value of the property in question. The language contemplates the utilization of other standards of valuation where such standards may provide for more equitable treatment of the parties than reference to the resale market would afford. For example, scheduled depreciation would be appropriate where a debtor seeks to redeem specialized manufacturing or processing equipment, peculiar to the debtor's business or profession and specialized needs, which has a limited or nonexistent resale value. In such situations, the debtor's proposed continued use of property of substantial utility militates against the use of any valuation scheme that does not provide a return to the creditor commensurate with the benefits afforded to the debtor by the redemption provisions of the section. Conversely, where the property in question has suffered substantial depreciation and is of limited use to either the debtor or creditor, liquidation value would be appropriately applied.

Section 7

(a) The new section 521(a)(2) created by subsection (a) requires the debtor to file a statement estimating his income and expenses for the year following the filing of the petition. Such a statement will provide creditors and the court with information which is relevant to the question of whether or not the debtor can pay a reasonable portion of his debts out of future income for purposes of a section 305 challenge. Subsection (b) of section 7 amends rule 203 to require that a copy of the statement of income and expenses so filed shall be forwarded to each creditor shown in the schedules at the time the notice of the section 341(c) meeting is sent out.

(b) The new section 521(a)(3) created by subsection (a) of section 7 contains provisions dealing with the disposition of property of the debtor which is subject to a security interest or lien. When the debtor files a bankruptcy petition, property which is security for consumer debts is almost invariably in the hands of the debtor. Usually, such property will be claimed as exempt, or will be abandoned by the trustee as being of little or no value to the estate. Although the 1978 Code seemed to require the property to be delivered to the trustee, and then delivered by the trustee to either the debtor or a secured creditor, testimony in hearings held on this section showed that this often did not occur. Instead, under the Reform Act provisions, the property frequently simply remained in the debtor's possession.

The debtor has several options with respect to such property. The debtor may claim the property as wholly or partially exempt, may seek to redeem the property, or may seek to retain the property by reaffirming all or part of the underlying debt. Or, the debtor may decide to surrender the property to the secured creditor.

The provision recognizes that secured creditors have a substantial, and perhaps even paramount, interest in such property. Accordingly, the debtor would be required to notify the secured creditor what he intends to do with the property within 10 days after the petition, and then, to perform his stated intention by the time of the meeting of creditors. If the debtor has not performed his intention by the meeting, the secured creditor is then free to enforce its lien. In situations where

there is a dispute over the respective rights of debtor and secured creditor, or in the rare case where the trustee will assert an interest of the estate in such property, the court may order the status quo to be maintained until any disputed matters are resolved.

(c). This amendment complements the amendments made in section 4—that the bankruptcy judge convene the meeting of creditors. Taken toegther, these amendments encourage the debtor and creditor to settle issues involving secured debt without judicial proceedings, but also enable the parties to identify disputed matters at an early stage so they may be resolved at the meeting of creditors. This will avoid the time and expense of separate and delayed proceedings.

The requirement should not be burdensome to debtors since these are matters that the debtor and his counsel must review and discuss in determining whether the debtor should file bankruptcy at all and if so, whether to file in chapter 7 or chapter 13.

Section 8

In response to problems encountered with the federal exemptions as enacted in the 1978 Reform Act, the section amends section 522 of the code to require individuals filing in joint or consolidated cases to elect either the federal or state exemptions together, and places an aggregate limit on the value of the exemption with regard to household goods and personal effects of $3,000. The section also prohibits the debtor from utilizing the unused dollar value of the homestead exemption to exempt additional property not explicitly provided for by the section.

This section also repeals the provisions of section 522(f) which authorize the debtor to avoid nonpurchase money security interests in property. The section should be read together with the provisions of section 722(b) which authorizes the court, upon notice and hearing, to require creditors to accept scheduled payments in redemption of the value of claims secured by nonpossessory, nonpurchase money security interests in the types of tangible personal property specified in section 522(f) over a period not exceeding 5 years.

Section 9

(a) Section 523 is amended and expanded to address a type of unconscionable or fraudulent debtor conduct not heretofore considered by the code—that of loading up. In many instances, a debtor will go on a credit buying spree in contemplation of bankruptcy. The new subsection (d) creates a rebuttable presumption that any debt incurred by the debtor within 40 days before the filing of the petition has been incurred under circumstances that would make the debt nondischargeable. Only that portion of a debt which was incurred within the 40-day time period is subject to this presumption. The burden is upon the debtor to demonstrate that the debt was not incurred in contemplation of discharge in bankruptcy and thus a fraudulent debt.

(b) The Reform Act's mandatory assessment of costs and attorney's fees against a creditor who objects to the discharge of a debt because of fraud, false pretenses, false representations or false financial statements, and does not prevail in the proceeding proved to have an undesirable chilling effect on good faith challenges to dischargeability. Consequently, the new section eliminates the mandatory language of

the previous version and restores discretion to the court to award costs and fees in appropriate cases. The new provision allows costs and attorney's fees only if the court finds that the proceeding was not brought in good faith and is intended to preserve the congressional intent of discouraging frivolous objections while at the same time avoiding the over-kill effect of discouraging well-founded objections.

Section 10

(a) The amendments to section 524(a) of the Code are intended to clarify congressional intent that a discharge does not operate to prohibit the enforcement of a lien upon property that has not otherwise been avoided by order of the Bankruptcy Court during the administration of the estate.

(b) The amendment to section 524(c) substantially revises the reaffirmation procedures of the 1978 act. Whereas the 1978 act required, as to reaffirmations of consumer debts, prior court approval for the agreement to be effective, the new section provides for immediate effectiveness of the agreement upon its filing with the court, subject to the court's review of the agreement pursuant to the exercise of its equitable jurisdiction. The purposes of the new section are (1) to lower the cost to the parties of the reaffirmation transaction; (2) to minimize the potential burden on the bankruptcy court, and (3) to ensure that the court is properly informed of such agreements so that it may exercise equitable powers to protect the debtor from overreaching creditors. While the purpose of the new section is to abolish the cumbersome "Miranda Warning" approach of the 1978 act, it is nevertheless intended that the court review will constitute more than a rubber stamp of the agreement. The key consideration should be ensuring that the debtor will not suffer an undue hardship by the execution of any reaffirmation agreements. In short, the debtor's fresh start should not be impaired by any such agreements.

It is anticipated that, in the vast majority of cases, the obligations of the court may be adequately discharged by brief inquiries to counsel and the debtor. Where the debtor and the debtor's counsel are in agreement that the execution of the agreement is beneficial to the debtor, the presumption should be in favor of ratification of the agreement.

The debtor is further protected by an expanded cooling off period, which is extended to 60 days. In cases where the debtor rescinds, or the court annuls, the reaffirmation agreement, such payments as may have been made to the creditor are to be returned to the debtor.

In all, the new section is designed to encourage the prompt execution and implementation of good faith reaffirmation agreements by eliminating the cumbersome and unnecessary prior approval procedures which inhibited debtors and creditors from consummating mutually acceptable debt retirement arrangements.

(c) The amendment to section 524(c) simplifies the procedure for advising the debtor of the nature and effect of discharge and reaffirmation, and directs the court to perform those functions at the meeting of creditors convened under section 341.

Section 11

Section 547(b) is amended to limit the trustee's power to avoid liens or recover payments made within 90 days of filing of the petition in

bankruptcy (within 1 year in the case of an insider) unless the creditor had reasonable cause to believe the debtor was insolvent. The trustee retains the power to avoid liens and recover payments where a creditor knowingly applies last minute pressure on an insolvent debtor in the hope of obtaining more favorable treatment that the creditor would receive in bankruptcy. The amendment will permit regular payments, made voluntarily by the debtor in the ordinary course of business and prior to filing of the petition, to be retained by the creditor.

It is the purpose of preference law to promote equality among creditors and to deter creditors from applying untoward pressure to the debtor in the hope of obtaining an advantage over other creditors in a prospective bankruptcy proceeding. This section clarifies that ordinary course payments are not intended to be attached by the trustee as preferences unless the creditor had reason to believe the debtor was insolvent at the time of the transfer.

The removal of the "reasonable cause to believe" requirement from the preference section in the 1978 act had unforeseen consequences in industries dependent upon installment credit payments.

The amendment will restore the balance in the section and permit only those payments which are true preferences to be recovered.

Section 12

This section conforms the numbering of section 554(c) of the Code to the provisions of the new section 521, to reflect the new section 521 (a)(1) in place of 521(1).

Section 13

The provisions of the new section 722(b) authorize a debtor, upon notice and hearing, to request an order from the Bankruptcy Court requiring the creditor to accept installment payments for the redemption of the property described in this section, for the redemption value, over a reasonable period of time not to exceed 5 years.

It is the purpose of the Code to preserve property which is necessary to the debtor's fresh start. That fresh start could be impaired if the debtor was forced to incur a high replacement cost for household goods having a low fair market value. It is inequitable to require the debtor to bear the high replacement cost of goods whose value may be relatively low.

Other provisions of the Code preserve the debtor's fresh start and protect his ability to retain collateral of the type described in this section without resorting to the harsh expedient of abolishing the lender's security interest. For example, chapter 13 allows the debtor to retain goods by paying their value over the life of the plan rather than in one lump sum. The time payment redemption is in lieu of the abolition of the lender's security interest contained in the Reform Act. Moreover, it is consistent with the original expectation of the parties that the debt would be paid out of future income, and with the debtor's continued use of the property.

When the debtor is permitted to redeem in installments the court should require regularly scheduled payments sufficient in amount to insure adequate protection of secured creditors' interests in the collateral during the payment period. The calculated dollar value of that security interest should include a reasonable rate of interest upon the

amount scheduled so as to protect the creditor from devaluation of his security interest during the redemption period, and to honor the contractual expectation of a reasonable compensation for the extension of credit on the original purchase. In determining what a reasonable rate of interest on the amount scheduled shall be, the court is expected to exercise sound discretion, having due regard for the expectations of the parties as embodied in the contract. The award of contract rates of interest is to be encouraged where such rates do not unduly burden the right of redemption and are consistent with interest rates prevailing, at the time of redemption scheduling, on similar installment contracts. However, the court may exercise its equitable powers to award lesser rates where the circumstances of the individual case dictate.

Section 14

This section conforms the numbering of section 1106(a)(2) of the Code to the provisions of the new section 521, to reflect the new section 521(a)(1) in place of section 521(1).

Section 15

This section conforms the numbering of section 1111 of the Code to the provisions of the new section 521(a)(1) in place of section 521(1).

Section 16

Section 1301 of the Code imposes a stay on attempts by a creditor to recover debts of the debtor by proceeding against codebtors during the pendency of a plan. The amendment allows for automatic termination of the stay in accordance with the provisions of subsection (c) where the codebtor is notified of the creditor's intention to take action with respect to the collection of the debt from the codebtor, and the codebtor or debtor does not object. At present, the stay may be terminated in such cases, but the Code requires creditors to seek court relief to effect the termination. The new section 1301(d) thus eliminates the needless expense of a court hearing to enforce an undisputed right.

In some situations, it may not be entirely clear whether the conditions for automatic termination of the stay have occurred; therefor, the provision sets up an informal mechanism to permit creditors and debtors to resolve such matters. Thus, a creditor who believes the stay has terminated may notify the debtor and codebtor of a proposed action against the codebtor. If the debtor or codebtor notifies the creditor that he believes the stay is still in effect within 10 days, any further action against the codebtor requires court authorization. If the debtor and codebtor fail to notify the creditor, then the creditor can carry out the proposed action.

Section 17

This amendment of section 1321 adds a new subsection (b) requiring the debtor to commence payments under chapter 13 plans upon the filing of the plan.

This change attacks the problem of debtors using depreciable property for many months in chapter 13 cases without paying anything to the lender, and then having the case dismissed or converted to chapter 7. Under the Bankruptcy Code, a considerable amount of time may elapse between the filing of the chapter 13 plan and its confirmation.

No provision in the Reform Act is made for the prompt commencement of payments. In order to promote completion of chapter 13 plans as quickly as possible, payments should begin when the debtor has filed the plan that he believes he can complete. If no plan is confirmed, the payments may be returned after deducting the costs of administration.

Chapter 13 trustees report that where payments commence near the time the plan is filed there is a much greater incidence of compliance with the plan; and in fact, some courts already require this by local rule. If payments are delayed until confirmation, the debtor may become accustomed to a level of expenditures which is difficult to reduce. Under the section as amended, the period between the filing of the plan and confirmation will provide a good test of whether the debtor will be able to carry out the plan. Where commencement of payment is delayed until confirmation of the plan, debtors frequently default, or must bear the time and expense of a separate proceeding to modify the plan.

Section 18

This section makes several changes in the provisions of the Code which regulate the requirements for chapter 13 plans.

First, the section creates a statutory declaration of congressional intent that nondischargeable claims should be paid in chapter 13 plans. This is accomplished by amendment to section 1322(a).

Section, by amendment to section 1322(b)(1), the section permits separate classification of nondischargeable and codebtor obligations so as to facilitate payment of the amount the holders of such claims would have received but for the chapter 13 proceedings. Separate classification of claims upon which there are codebtors is warranted by the practical reality that the debtor is often compelled by circumstances to pay such claims in full. Frequently, the codebtor is a friend, relative, or employer, and will have posted collateral. If such claims are going to be paid anyway, it is important that they be considered in determining the feasibility of the plan.

Third, this section—in conjunction with section 1325(a)(6)—extends the standard plan length from 3 to 5 years. The present, 3-year provision was originally established in 1938 when maturities on consumer debts were much shorter than they are today. The option to pay over 5 years is consistent with the recent trend toward longer term credit obligations for automobiles and other consumer goods, and the increasing willingness of consumers to use second mortgage debt which may have a maturity of 10 years or more. Since a consumer using chapter 13 is essentially seeking to convert short term debt into longer term debt, the longer maturity is eminently justified. Moreover, the longer maturities of secured debts means that funds often will not be available to pay any substantial portion of unsecured claims during the first 2 or 3 years of a chapter 13 plan. It is only the 3d, 4th, and 5th years of a plan that meaningful payments to unsecured creditors may be expected, and the change is reflective of this fact. Thus, the longer payment period will benefit debtors (through reduced monthly payments) and creditors alike.

Section 19

This section addresses the requirements enunciated in section 1325(a) which must be satisfied for the court to confirm a chapter 13 plan.

Although the Code requires creditors to receive at least as much as they would receive in a chapter 7 case, this is not a meaningful standard since it looks to the consumer's nonexempt assets and most consumers have little or no nonexempt property. The good faith standard has been subject to varying interpretations as to whether (1) a minimum payment is required; (2) subjective good faith or some sort of substantial effort is necessary; and (3) all of the debtor's income which is not essential for support must be devoted to the plan.

It is the intent of the Congress to require the debtor to make a substantial effort to pay his debts. Such an effort may require sacrifices and some reduction in consumption. Thus, subsection (a) of the amendment, which adds new language to subparagraph 1325(a)(3), requires the debtor to devote that portion of his income which is not necessary for the support of the debtor and his family to the plan. It recognizes that the debtor's first obligation is that of support, but that income not neecssary for support must be devoted to the plan. The amendment thus resolves the uncertainty in the case law by making it clear that (1) income not necessary for support is to be committed to the plan; and (2) no minimum payment to creditors is required.

Finally, the amendment (in subsection (d)) would require the plan to last for a period of 5 years, or to pay a reasonable portion of allowed unsecured claims. What a reasonable portion of allowed unsecured claims is will be determined on a case-by-case basis but it is expected that the standards will closely parallel those employed for the determination of section 305 challenges in chapter 7 cases. In general, and excluding hardship circumstances, a debtor should contemplate the repayment of at least 70 percent of the allowed unsecured claims for a proposed plan that has a duration of no more than 3 years, unless the repayment of that percentage of such claims would be unfeasible even if the plan were to extend over a greater period of time.

Section 20

(a) Subsection (a) of this section, by amendment to section 1328(a)(2) of the Code, conforms the treatment of nondischargeable debts in chapter 13 to that accorded in chapter 7 of the Code. Under section 523(a) of the Bankruptcy Reform Act, a number of claims not dischargeable in a chapter 7 proceeding were dischargeable in chapter 13 proceedings upon completion of a plan. The only exceptions were alimony and child support claims. Remaining nondischargeable debts were dischargeable even if the debtor proposed to pay little or nothing in satisfaction of the claims, for although section 1325(a)(4) required unsecured creditors to receive as much in chapter 13 proceedings as they would in chapter 7, this provision was historically interpreted by the courts to allow chapter 13 claimants only as much as they would have received from a liquidation of the debtor's property. This standard did not, of course, consider the fact that creditors with nondischargeable claims normally have access to postpetition earnings and property. The provisions of the Reform Act encouraged debtors to propose the lowest possible payout of nondischargeable claims to assure completion of the plan, and the amendment corrects this defect in the Code by prohibiting discharge upon completion of the plan of any section 523(a) debt not paid out in the plan.

(b) Subsection (b), by amendment to section 1328(c)(2), provides further incentive to satisfy section 523(a) obligations in chapter 13 proceedings by allowing hardship discharge of such debts, to the extent they are proposed to be paid by the plan, when unforeseen circumstances prevent the debtor's ability to complete the plan.

VI. Budget and Regulatory Impact; Cordon Rule

A. BUDGET IMPACT

U.S. Congress,
Congressional Budget Office,
Washington, D.C., May 4, 1982.

Hon. Strom Thurmond,
Chairman, Committee on the Judiciary,
U.S. Senate, Washington, D.C.

Dear Mr. Chairman: Pursuant to section 403 of the Congressional Budget Act of 1974, the Congressional Budget Office has reviewed S. 2000, the Bankruptcy Improvements Act of 1982, as ordered reported by the Senate Committee on the Judiciary, April 20, 1982.

The bill amends title 11, United States Code, to modify the basis for providing bankruptcy relief under chapter 7. Other procedural changes involve requirements of and actions to be taken by either the debtor or the creditor. Based on information provided by the Administrative Office of the U.S. Courts, it is expected that no significant additional cost to the Government will be incurred as a result of enactment of this legislation.

Should the committee so desire, we would be pleased to provide further details on this estimate.

Sincerely,

Alice M. Rivlin,
Director.

B. REGULATORY IMPACT EVALUATION

In compliance with rule 29.5 of the Standing Rules of the Senate, the committee finds that no significant regulatory impact as defined by that subsection will result from the enactment of S. 2000.

C. CHANGES IN EXISTING LAW

In the opinion of the Committee on the Judiciary, it is necessary in order to expedite the business of the Senate to dispense with the requirements of subsection 4 of rule XXIX of the Standing Rules of the Senate—relating to the showing of changes in existing laws made by the bill, as reported. The committee feels this is justified as the changes made by this bill are obvious and a further explication of their effect on existing law is not necessary.

ADDITIONAL VIEWS OF SENATOR CHARLES McC. MATHIAS, JR.

I submit individual views of the committee report on S. 2000 because of my concern that several of the important issues that the bill addresses have not yet had an adequate airing. I hope my individual views will prompt a full discussion of these issues when we debate S. 2000 on the Senate floor.

The impulse for this bill stems from the sizable increase in personal bankruptcies since 1978. If it is true that the bankruptcy law Congress passed that year is in part responsible for this development by swinging the pendulum too far in favor of the debtor, I am concerned now that S. 2000 will swing it too far back in the other direction, in a way that will require congressional attention again a few years down the road. I think we should try to find the mean this time.

I am particularly concerned about the proposal in section 3 to deny access to chapter 7 bankruptcies to a debtor if the individual can pay a portion of his debt out of anticipated future income. I gather from my discussions with bankruptcy practitioners and other persons with an interest in the bill that this proposal appears to remain a point of heated controversy. It would be a basic departure from bankruptcy policies our country has embraced for nearly 100 years—a departure that has been specifically rejected by Congress three times in the past. Many of the calls and letters my office has received suggest to me that there is a very profound misunderstanding on this point. They all urge that I vote to correct the excesses of the 1978 act. This provision goes far beyond any of the changes brought about by that act, and I don't think this point is adequately appreciated. I understand that only 1 day of hearings has been held on the proposal in the present Congress. The Senate will have to take a longer look at it, and to take more time trying to find if a consensus can be worked out among the interested parties.

Although I do have reservations about other parts of the bill, I will limit my specific comments to the future income provision, which has generated the greatest interest. In the end, we may decide that the great changes that have occurred in the United States—with credit cards replacing cash, and easy credit the rule rather than the exception—require profound changes in the bankruptcy laws. Before we throw aside 100 years of experience, however, I think we have an obligation to debate it fully and consider all possible alternatives.

CHARLES McC. MATHIAS, Jr.

MINORITY VIEWS OF SENATORS METZENBAUM AND KENNEDY ON S. 2000

I. Introduction

S. 2000 represents a radical and unwise departure from nearly a century of American bankruptcy tradition. It is likely to place overwhelming burdens on decent and hardworking Americans who have fallen on hard times through no fault of their own. In doing so, it creates a situation where debtors would potentially be forced to mortgage their futures to pay for past misfortunes.

For nearly 100 years, debtors in this country, overwhelmed by their financial troubles, have been able to obtain a fresh start by surrendering most of their valuable assets. Such a fresh start has been a right accorded all debtors as long as they were willing to make the sacrifice of surrendering most of their valuable property. As the Supreme Court in *Local Loan Co.* v. *Hunt*, 292 U.S. 234 (1934) explained:

> One of the primary purposes of the Bankruptcy Act is to "relieve the honest debtor from the weight of oppressive indebtedness and permit him to start afresh free from the obligations and responsibilities consequent upon business misfortunes" * * * [such a fresh start provides bankrupts] "a new opportunity in life and a clear field for future effort, unhampered by the pressure and discouragement of preexisting debt. 292 U.S. at 244.

S. 2000, however, denies debtors a right to this "new opportunity in life." Under S. 2000 most debtors seeking a fresh start, regardless of their financial situation, are likely to be put to the test of demonstrating their inability to pay back past debts out of their future income over a 3- to 5-year period. This is the antithesis of the fresh start principle.

Whereas debtors now have an automatic right to "a clear field for future effort," if this bill passes, they face the onerous burden of proving that there is no room in their future budget to meet subsistence living expenses in addition to paying back past debts.

If they successfully persuade the court, the debtors will be given their fresh start. But they will still have been put through the lengthy, complicated, and tremendously demeaning task of demonstrating that they are too poor to meet their financial obligations. With the changes made by the bill in the area of attorney fees, they are likely to be burdened as well with the substantial costs incurred in demonstrating to the court that they are too poor to pay off their past debts, let alone their attorney fees.

If they are denied a fresh start, they will face what for most will be the overwhelming task of meeting daily living expenses and simultaneously paying off past debts plus the attorney fees incurred in their

unsuccessful effort to obtain chapter VII relief. They will be "hampered by the pressure and discouragement of preexisting debt"—precisely the situation our bankruptcy laws have historically sought to avoid. In essence, these debtors will face a modern day form of involuntary servitude.

Wage earners faced with this enormous drain on their future budgets may well be driven to quitting their jobs just to obtain the fresh start that motivated them to file for bankruptcy initially. A debtor seeking a fresh start may understandably think that unemployment may provide the only certain avenue to a clear future—a future without years of constantly increasing payments caused by continued high interest and finance charges.

Today, the average family filing for bankruptcy earns $10,000 to $15,000 a year. They have frequently had a tremendous financial setback, such as loss of a job or major illness, which has left them unable to make ends meet. They are honest individuals, reluctant to default on their past debts, but who have no choice given their current financial distress. In today's troubled economy, with soaring interest rates and record unemployment, there are more and more families in this situation. There is simply no justification for making such individuals jump through hoops to demonstrate that they are unable to meet their past obligations. And any court that would burden such families with their past debts would surely be working an injustice.

Not only would S. 2000 place tremendously unfair burdens on already seriously distressed families, it threatens to crush our current Banktruptcy Courts as well with unmanageable administrative costs. The test which S. 2000 requires bankruptcy judges to apply, that is, whether debtors can pay a reasonable portion of their debt out of "anticipated future income" over a 3- to 5-year period, is essentially unmanageable. Its standards are vague, calling for highly speculative judgments by the individual bankruptcy judges. It inevitably means that the Bankruptcy Court must continue to involve itself with the individual debtors' budget over a 3- to 5-year period.

It is not surprising that one bankruptcy judge testified at our hearings on S. 2000 that the "added anticipated deluge" of cases resulting from passage of S. 2000 "could not be handled with justice and dispatch." [1]

The bill's eligibility test for fresh start is not only opposed by the more traditional defenders of consumer rights. The bankruptcy judges themselves, those who would have to administer that test, find it unworkable and unfair. The American Bar Association's Consumer Bankruptcy Committee has also criticized the eligibility test.

What these groups and others recognize is that it is bad public policy to turn our backs on nearly a century of bankruptcy tradition and to tie up the scarce resources of our Bankruptcy Court system. It is particularly unwise to make these changes in the middle of the current economic crisis. Our economy has been ravaged over the past several years by the combination of oppressive interest rates, unprecedented inflation, and record post-war unemployment. This is certainly not

[1] Testimony of Judge Dean Gandy, president, National Conference of Bankrupty judges, hearing before the Subcommittee on the Courts of the Judiciary Committee, U.S. Senate, 97th Congress, 1st session (Oct. 29, 1981) pt. 2 ("Hearing") at 150.

the time to be shifting the balance against those most severely affected by these economic upheavals.

We are not suggesting that abuses of the bankruptcy law have not occurred. They have. But such abuses can be remedied far short of the broad, burdensome future income eligibility test. For example, creditors have complained that persons with extensive assets have been able to file for chapter VII bankruptcy and still hold on to those assets. S. 2000 adequately addresses this concern by placing a $3,000 cap on the exemptions a debtor can claim for personal and household property items valued at under $200 each in a chapter VII filing. To deny everyone the automatic right to a fresh start in order to deal with this problem is simply overkill.

There have been several efforts in the past to legislate away the right to a fresh start—once 50 years ago and again during the 89th and 90th Congresses. On both occasions these efforts failed dismally. We fervently hope this most recent effort to turn back the clock on enlightened principles of bankruptcy law will meet a similar fate.

Most debtors do not willingly default on their financial obligations. They declare bankruptcy only as a last resort. We encourage that sense of responsibility. But we also firmly believe that those who truly find themselves unable to stay afloat financially must continue to have the right to "start afresh free from the obligations and responsibilities consequent upon business misfortunes."

II. Description of S. 2000's Threshold Test and Attorney Fees Provisions [2]

A. THRESHOLD TEST

S. 2000 eliminates the fresh start cornerstone of American bankruptcy law by creating an eligibility test that must be met by debtors before they can obtain bankruptcy relief under chapter VII. If S. 2000 becomes law. debtors will not have the automatic right to declare chapter VII bandruptcy; instead they may be put to the burdensome task of demonstrating that they cannot pay a "reasonable portion of their debts" out of "anticipated future income" over a 3 to 5 year period.

B. ATTORNEY FEES

S. 2000 makes it more difficult for debtors to obtain attorney fees if they succeed against creditor challenges during the bankruptcy proceedings. S. 2000 creates a presumption against the award of attorney fees which can be overcome only with a finding that the creditor did not act in good faith. The 1978 bankruptcy law, on the other hand, created a presumption in favor of awarding attorney fees to prevailing debtors. This was an attempt to protect honest debtors from creditors who used the threat of litigation to force debtors into paying debts that were dischargeable. S. 2000 removes this protection from debtors.

[2] The bill also makes other changes in current bankruptcy law. Some of these changes, such as creating a presumption that a debt incurred 40 days prior to filing for bankruptcy is fraudulently incurred, seem excessively harsh. Others, such as "requiring debtors who file joint petitions and married couples who file individual petitions to choose between using State or Federal exemptions seem reasonable. In the interest of time, we have discussed only our two major concerns with S. 2000.

III. Background: The Fresh Start Concept

A. Origins of the fresh start principle

Creditors would have us believe that the notion of giving debtors a fresh start originated with the Bankruptcy Act of 1978. That is simply not the case. As early as 1705, Great Britain's Queen Anne's Act made provisions for discharge of the bankrupt "who shall, within the time limited by this act, surrender him, her, or themselves—and in all things conform as in and by this act is directed . . ." Remington on bankruptcy (5th ed., Henderson, ed.) (1950) at 14.

In 1841 the United States enacted its second national bankruptcy act [3] which contained provisions for the discharge of debtors who had surrendered all their assets in voluntary bankruptcy proceedings. As explained in the Remington treatise on bankruptcy law:

> * * * [the act of 1841] recognized, on the other hand, the justice of granting to the honest debtor who had surrendered all his assets and had truthfully revealed all facts in relation thereto, and had aided his creditors in realizing as much as possible from the estate, a discharge and release from his remaining debts—the justice of lifting from his shoulders the burden of hopeless debt that otherwise would have obliged him either to abandon all business enterprise or else to do business under cover of another name. (Remington on bankruptcy [5th ed., Henderson, ed.] [1950] at 14.[4]).

While the 1841 act required consent of two-thirds of the creditors in number and in value before discharge was granted, in 1898 the requirement for creditor consent to discharge was completely removed. (Testimony of Prof. Vern Countryman before the House Subcommittee on Monopolies and Commercial Law, March 25, 1982.) Thus, since at least the mid-1800's our Bankruptcy Code has provided for discharge of the honest debtor in a voluntary bankruptcy proceeding. Since the late 1800's, debtors have had a right to such discharge and the fresh start that entails without creditor approval.

The most recent amendments to our national bankruptcy statute, the Bankruptcy Act of 1978, left unchanged the historical concept of a fresh start. Proponents of S. 2000 nevertheless attempt to bootstrap their proposal to deny debtors a fresh start with arguments about abuses arising out of the Bankruptcy Act of 1978. That act, the argument goes, so liberalized bankruptcy law that bankruptcies have increased astronomically. Therefore, we must reverse nearly 100 years of bankruptcy tradition to discourage bankruptcies by denying debtors a fresh start.

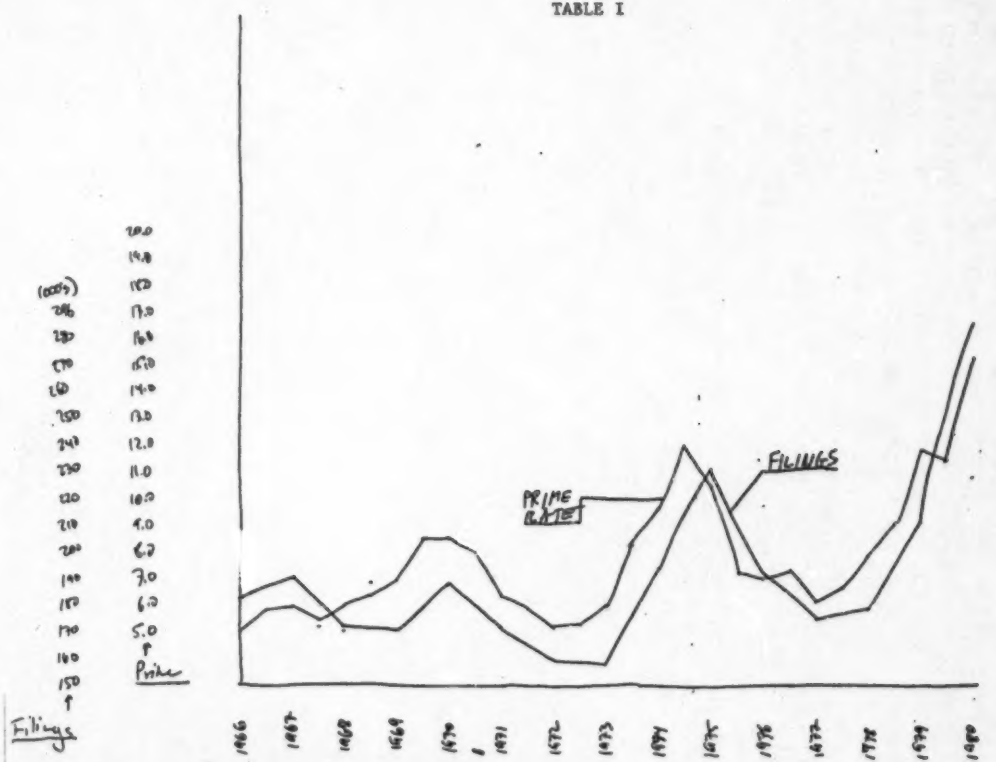
The absurdity of this position must be apparent on its face. Since the concept of a fresh start existed for nearly 100 years prior to enactment of the Bankruptcy Act of 1978, that principle cannot be responsible for whatever trend toward increased bankruptcies we may now

[3] Our first bankruptcy act, enacted in 1800, was limited to involuntary proceedings against businessmen.

[4] To be sure the 1841 Bankruptcy Act and subsequent acts did deny discharge to some debtors. Discharge was denied to debtors who bore some blame for the position they were in—who either fraudulently induced creditors to lend them money or who deliberately exposed themselves to a severe loss of income in order to defraud their creditors.

be experiencing. Moreover, it is highly unlikely that the 1978 act is the cause of increased bankruptcies. As several witnesses at hearings on S. 2000 pointed out, the increase in our current bankruptcies corresponds to an increase in credit outstanding, in interest rates, in unemployment and in greater consumer awareness as a result of attorney advertising on the subject of individual bankruptcy rights. Any one of these factors could explain the recent increase in bankruptcies. As table I below shows, there is a remarkable parallel between interest rates on the one hand and chapter VII filings on the other.

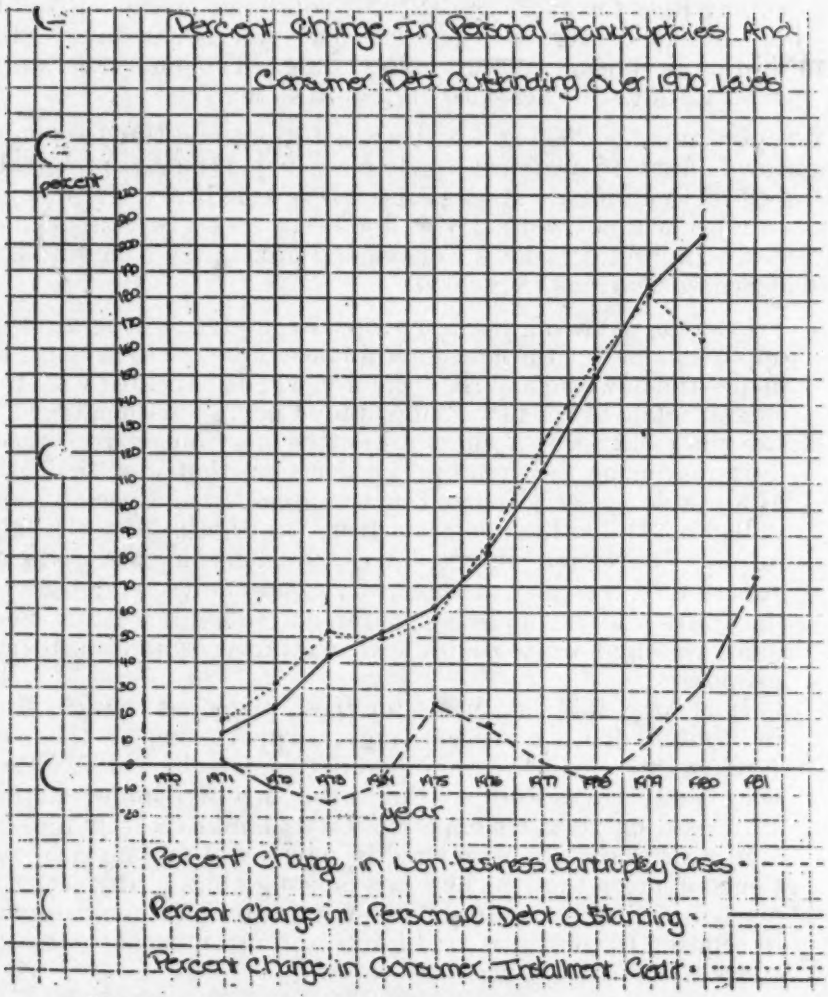
TABLE I



SOURCES:
No. of Filings - Administrative Office of U.S. Courts
Prime Rate - Public Information Office, Federal Reserve Board

Table II below shows a similar relationship between credit outstanding and bankruptcy filings.

TABLE II


Percent Change In Personal Bankruptcies And
Consumer Debt Outstanding Over 1970 Levels
percent
year
Percent Change in Non-business Bankruptcy Cases.
Percent Change in Personal Debt Outstanding.
Percent Change in Consumer Installment Credit.

Source: Table Released by House Judiciary Subcommittee on Monopolies and Commercial Law, October 16, 1981, relying in part on Economic Report of the President, 1981, Tables B66, B67, and B68

In fact, as one witness pointed out at Senate hearings on S. 2000:

> (T)he number of bankruptcy cases commenced in relation to consumer credit outstanding has decreased substantially and is less now than in 1969. In 1969 there was one bankruptcy case for every $610,230 of consumer credit outstanding. In 1980 there was one bankruptcy case for every $1.2 million in consumer credit outstanding. (Testimony of Bankruptcy Judge Joe Lee, hearing, *supra* at 168.)

Proponents of S. 2000 ignore these factors, attempting to camouflage their own efforts to overturn nearly a century of bankruptcy tradition as an effort to eliminate abuses caused by the 1978 act. That sleight of hand simply will not work. Judge Joe Lee, who is also chairman of the American Bar Association's Consumer Bankruptcy Committee, testified at Senate hearings on S. 2000:

> It seems to me highly inappropriate, and smacking of rank opportunism, for the consumer finance industry to attempt to utilize the downturn in the economy, which coincided with the effective date of the new Bankruptcy Code, as justification for sweeping changes in the substantive law and court procedures, ignoring the sound policy decisions that were the basis of a law so recently enacted by Congress. I am especially appalled at a bill which detracts from the dignity of the Bankruptcy Court and imposes on and demeans the judicial function of the court without any opportunity for judges of the court and the judicial conference to evaluate the enormous cost and waste of judicial manpower inherent in such proposals.
>
> It is suggested as a basis for these proposed changes that individual debtors are abusing the provisions of the new Bankruptcy Code by seeking relief under chapter 7. When they could just as well pay their debts in a plan under chapter 13. Based on 20 years experience as a bankruptcy judge, including 2 years administering the new law, I find no basis for the contention that the new law is being abused. In fact, it is my belief that there are now fewer individual bankruptcies in relation to consumer credit outstanding than there were 10 years ago. Hearing, *supra*, at 166–167.

There are strong policy arguments against elimination of the fresh start concept given the serious economic situation in which we find ourselves. These will be discussed more fully in the following section. Suffice it to say at this point that depression breeds bankruptcies. The problem is endemic. The solution is not to cut the bankrupts' lifeline—it is to give them a hand up and out of their desperate plight.

B. PAST UNSUCCESSFUL EFFORTS TO ELIMINATE FRESH START

S. 2000 is not the first effort to remove the fresh start as the baseline for personal bankruptcy. On at least two prior occasions, proposals to eliminate or severely undermine the fresh start principle have been considered by Congress—and quickly rejected. The 89th and 90th

Congresses entertained a proposal similar to that in S. 2000. That proposal was never reported from the House Judiciary Committee.

Almost 50 years ago, a proposal to suspend bankruptcy discharges until the debtor had paid off or reduced his existing debts out of future income was also entertained by Congress. This proposal too was never reported out of committee. Opposition to the proposal was fierce. As Vern Countryman, professor of law at Harvard University and vice chairman of the prestigious and influential National Bankruptcy Conference, testified:

> That proposal provoked vehement opposition in congressional hearing—it is to my knowledge the only proposed bankruptcy legislation to be characterized by witnesses as un-American. Hearing, *supra*, at 137.

A proposal to deny discharge to honest debtors is no more meritorious today than it was 15 years ago or 50 years ago. It should be promptly rejected.

IV. Arguments Against the Future Income Threshold Test

A. S. 2000 Is Unfair to and Will Severely Burden the Working Poor and Lower Income Families Who Through No Fault of Their Own Are Unable to Make Ends Meet

In an effort to deny chapter VII relief to the few truly well-off families that might be able to pay off their past debts out of future income, S. 2000's anticipated future income test will place severe burdens on the working poor and lower income families who are tryning desperately to make ends meet.

Studies have shown that the vast majority of bankruptcies are blue-collar workers, between 25 and 35 years of age, who have suffered financial reverses such as unemployment, uninsured illnesses, or divorce. Joanne S. Faulkner, "Proposed Bankruptcy Amendments May Revive Creditor Abuses," the Connecticut Law Tribune, February 1, 1982.

A detailed case study of the Connecticut bankruptcy experience in 1979 revealed that the mean annual income for those filing bankruptcy was $11,744. The average debtor had a total outstanding debt of $10,633. Hearing, *supra*, at 91–92.

As one witness characterized the kind of debtors that ended up in bankruptcy:

> [The debtors in our study] were near poor. * * * Their mean and median incomes are both below the Bureau of Labor Statistics' lower living budget. That lower living budget for a family of four in 1979, when our people reported their income—our sample group—was on the order of $12,700. Our people were earning more than $100 a month less than that.
>
> If you think that one can begin to take 10, 15, 20, or 25 percent out of people like this, I suggest to you that you might be pushing them right to the edge of poverty. These people have unstable incomes; they are mostly employed in marginal activities, mostly on an hourly wage without steady employ-

ment; their incomes fluctuate considerably; and even those few that had increases in income showed, in our entire sample, an increase of about 6 percent from 1978 to 1979. During that same period, the Consumer Price Index, which measures cost of living, rose over 14 percent.

In terms of actual buying power, even the best off of our group were worse off in 1979 than they had been in 1978. Testimony of Phillip Shuchman, professor, Rutgers University School of Law, hearing *supra*, at 71–72.

In testimony before the House Subcommittee on Monopolies and Commercial Law on March 23, 1982, Christopher N. Guiliana, Esq. of the United Auto Workers Legal Services Plan in Newark, N.J., presented a similar profile of the type of people his ogarnization serves in bankruptcy cases. Most of the plan's clients were employed, hourly workers who had experienced disruptive layoffs, wage freezes, and loss of cost of living and other benefits through wage agreements designed to help keep Chrysler Corp. afloat. While laid off, these workers saw their gross weekly income shrink by over one-half. Many of them relocated in order to keep their jobs, which added an additional burden to their strapped financial condition. Most were one-wage earner families, so that when layoffs came, there was no second income to supplement their meager unemployment benefits.

Debtors in this position are not trying to run out on their creditors. They have just been pushed beyond the limits and see no alternative to bankruptcy.

Even if these individuals are ultimately permitted chapter VII relief, S. 2000 will still subject them to lengthy and costly litigation to demonstrate their inability to pay their debts out of future income. Nor, given the changes made in S. 200 in the attorney fees standards, can they even count on being able to recover the attorney fees expended in demonstrating their eligibility for chapter VII.[5]

Although creditors may not challenge every chapter VII filing, we can anticipate that they will do so as a matter of routine in most cases. The costs of filing a challenge would be nominal. Standard forms can be used and any costs incurred can be deducted as business expenses. Moreover, since the risks of being charged with the debtor's attorney fees are significantly lessened, there is no reason to expect creditors to forego routine challenges to chapter VII. Hearing, *supra*, at 128.

Debtors do not come easily to the decision to file for bankruptcy. They do not lightly decide to surrender all of their nonexempt property in return for a fresh start.[6] The decision to file for chapter VII clearly has its costs to the debtor. There is simply no justification for placing the extra burden on debtors of demonstrating that they will remain too poor to pay off their debts. We see no reason to require debtors already strapped and fearful of the future to jump through these extra hoops before they finally are given a fresh start.

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[5] The attorney fees isue is discussed in section V.

[6] Creditors have complained that the generous Federal exemptions enacted by the 1978 Bankruptcy Act allow debtors to discharge their debts without giving up much of their property. A Dole-Metzenbaum amendment to S 2000 removes this possibility of debtor abuse by tightening up the Federal provision. The amendment requires married debtors filing individual bankruptcy petitions and individuals filing joint petitions to choose either the Federal or State exemptions; it puts a cap of $3,000 on the exemptions a debtor can claim for personal and household property items valued at under $200 each; and it prevents the use of the $7,500 homestead exemption (or any part of it) to exempt personal property.

In fact, denying debtors chapter VII relief and essentially requiring them to pay off their debts over a 3-to-5-year period is not too far from involuntary servitude, a practice long outlawed in our society. Prof. Vern Countryman noted:

> The 13th amendment provides that, except as a punishment for crime, involuntary servitude shall not exist in the United States. Acting under that amendment, the Congress long ago abolished peonage in the United States (42 U.S.C. section 1984) and made it a crime to hold a person in a condition of peonage (18 U.S.C. section 1581). In upholding the validity of those statutes, the Supreme Court defined peonage as "a status or condition of compulsory service, based on the indebtedness of the peon to the master. The basal fact is indebtedness." *Clyatt* v. *United States*, 197 U.S. 207, 215 (1904). Hearing, *supra* at 141.

The bill's anticipated future income test also discriminates against the individual, noncorporate debtor. Corporations are never required to continue operations for 5 years in order to pay off or reduce existing debts, nor would S. 2000 require them to do so. In fact, as pointed out at Senate hearings, "a certificate of incorporation is, for the stockholders, a bankruptcy discharge in advance." Hearing, *supra*, at 142. Only the individual consumer and the small business owners that are frequently required to accept personal liability to obtain loans would be put to such a harsh test.

Finally, with respect to the fairness question, we must point out the fear expressed by some witnesses at Senate hearings on S. 2000 that the bill is just the beginning of creditor efforts to undermine debtor rights. Bankruptcy Judge Joe Lee testified:

> Any sort of restriction or access to bankruptcy should be accompanied by a restriction on their [creditors'] rights, such as the abolition of garnishment entirely or a restriction on enforcement of deficiencies on repossession of items.
>
> I do not think this is a one-way street. There has to be a balanced approach to this problem, because if they succeed here in tightening bankruptcy, then they will go to the States and try to tighten up the State collection laws, and the debtors' legal environment in the State will further deteriorate. I think this law that we enacted in 1978 has improved the legal environment of debtors in States in the form of exemptions and otherwise, and I would hate to see that trend reversed. Hearing, *supra*, at 146.

Our society is not well-served by rolling back the clock on protecting the legal rights of debtors.

B. The Anticipated Future Income Test Is Unworkable and Will Severely Overburden the Courts

S. 2000 will require bankruptcy judges to make determinations that they are ill-equipped to make about debtors' future earning capacity and future expenses. The bill would require these judges

to make highly speculative judgments initially about what debtors' anticipated living expenses are and what their future employment prospects are. It then requires the judge to determine whether a reasonable portion of the debts can be paid off in light of the financial situation hypothesized. Such a test raises more questions than it answers. How is a judge to determine what a family's living expenses are? In these times of variable rate mortgages where the monthly payments will vary with some measure of the market interest rate, how is the judge to predict what the debtors' mortgage expenses will be?

What about educational expenses for the debtor's children? Should the bankruptcy judge be permitted to take into account parochial school expenses? Should college be considered in calculating the debtor's future expenses? If college expenses are to be included, would the judge be required to set a limit on the amount of tuition or room and board that could be paid? The questions are endless. The bankruptcy judges themselves are understandably concerned about how to determine a family's reasonable living expenses. Judge Dean Gandy, testifying on behalf of the conference of bankruptcy judges said:

> The extent to which any given item of expense differs from the reasonable norm will have a direct relationship to the net income remaining. This, then, requires the bankruptcy court to determine the reasonable norm for expenditures in the community. What is reasonable, for example, for transportation? Should the debtor be required to always ride the bus? Is a 1980 large car reasonable, or should it be a small one, or should it be a 1975 model? Bankruptcy courts have always been required to make difficult decisions, but the determination of the reasonable norm for expenses throughout a community applied to individual circumstances of despair or irresponsibility is mind-boggling. Hearing, *supra*, at 152–153.

What assumptions should the bankruptcy judge be making about the debtors' appropriate standard of living during the 3-to-5-year repayment period? How is the judge to make predictions about the likelihood of continued employment over the next 3-to-5-years? Our depressed economy has eliminated job security in all sectors of the work force. Even in good times, the average length of time a worker stays on any one job is only a little over 3 years. That number appears to have steadily declined over the past several years.[7] In light of the unpredictability of job tenure, how could a bankruptcy judge predict with any confidence that a debtor will have a steady income over the entire 3-to-5-year repayment period?

Even assuming accurate predictions could be made about future income streams and future family expenses, the judges would still have to make the highly subjective judgment about what constitutes a reasonable portion of the debt. The pitfalls and uncertainty here are even greater. The witness testifying on behalf of the conference of bankruptcy judges pointed out:

[7] The Bureau of Labor Statistics reports that in 1973 the average length of time on a job for U.S. workers was 3.9 years. In 1978 the average was 3.6 years, and in 1981 it was 3.2 years.

> Determination of what is a reasonable portion of debts and what is future income could be highly speculative, would be applied in a nonuniform way throughout the country, and even between different debtors in the same court. What is a reasonable portion may very well relate to the identity of the creditors, and the circumstances under which the debts were incurred. For example, would debts generally owed to unsophisticated investors who innocently trusted the debtor require a larger percentage of payment than debts owed to lending institutions that used advertising tactics to secure the debtor as a customer? Would the existence of a large profit margin as to one creditor result in a different application of the rule than as to a creditor who had no profit at all? Testimony of Judge Dean Gandy, hearing, *supra*, at 152.

Bankruptcy judges could not be charged with a more speculative task than that called for under the bill's threshold anticipated future income test. Even the majority report's attempt to suggest the parameters of what constitutes a reasonable portion [8] does not cure the underlying problems of predicting the family's future income and expenses. Nor does it lessen the likelihood that there will not be uniform application of the future income test. Uniform bankruptcy laws are mandated by our Constitution. S. 2000's future income approach makes uniform application of our bankruptcy laws a virtual impossibility.

As noted above, bankruptcy judges themselves are not comfortable with applying the bill's future income test. That is a major reason for their strong opposition to the bill's threshold test. Further, not only will bankruptcy judges be called on to make highly speculative judgments about the debtors' future ability to pay, the process of establishing debtors' eligibility for chapter VII will strain the limits of the already crowded bankruptcy court dockets. As Judge Gandy testified for the Conference of Bankruptcy Judges:

> Motions raising this issue [threshold test] could be expected to flood the bankruptcy courts. Those courts are now extended beyond all reasonable limits, and this added anticipated deluge could not be handled with justice and dispatch. * * * The judges present in Detroit [at the bankruptcy judges annual convention] felt that motions raising the reasonable efforts issue would far exceed any other type issue ever submitted in a bankruptcy context, and would require extensive trials of highly complicated matters. If it could be anticipated that the court system could be expanded quickly to accommodate all of this added business, this might not be a valid objection, but none of the judges who spoke on this issue felt it could be accomplished except in a matter of several years. During that time interval, we feel the cases will have to be postponed, or given only a cursory look. If they are postponed, the debtor would have no relief, and

[8] The report suggests a presumption that debtors who can only pay 25 percent of their past debts out of anticipated future income should be permitted to file for chapter VII, while those able to pay 75 percent should bear the burden of overcoming the presumption that they should not be able to file for chapter VII bankruptcy.

> if they are given only a cursory consideration, many errors could result. Hearing, *supra*, at 150–152.

Neither postponing cases nor giving them only a cursory review would be in the interest of creditors or debtors.

C. THE TEST WILL SET UP PERVERSE INCENTIVES FOR BOTH DEBTORS AND CREDITORS

Preventing debtors from filing for chapter VII bankruptcy could encourage inprovident lending. Hearing, *supra*, at 133–134. If a creditor knows it will be difficult for a debtor to discharge his debts, the creditor may be more willing to make risky loans. The creditor may offer to renegotiate the loan when the debtor gets into financial difficulty but is not allowed to file for chapter VII straight bankruptcy. Of course, when a loan is renegotiated, a debtor pays a prepayment penalty for paying off the first loan, pays a loan origination fee for the new loan, and, if the prevailing interest rate is higher, pays more interest. All of this benefits the creditor, but does nothing to help the debtor's financial situation.

A September 1981 report by the National Credit Union Administration found that in 57 percent of the chapter VII bankruptcy cases where a credit union's loan was discharged, the credit union had not even obtained a credit report on the debtor. Report in the special bankruptcy profile survey. National Credit Union Administration (September 1981) at 27. This is under current law. What will happen if S. 2000 becomes law? At what point do we have a responsibility to ensure that the credit industry exercises care in lending instead of relying on the Federal Government to perform the industry's debt collection service? As one witness at the Senate hearings on this measure testified:

> What this proposal entails is that the bankruptcy courts will function as free official collection agencies, presumably ready to enforce their orders by wage garnishment (a new and perhaps unlawful activity) or by contempt proceedings, civil and perhaps criminal in some cases. I take it that imprisonment (fines are not apt to work with debtors) will be the ultimate threatened sanction." Testimony of Prof. Phillip Shuchman, hearing, *supra*, at 129.

Not only might the bill create incentives for creditors to lend improvidently, it may well encourage debtors to quit their jobs or forego seeking employment in order to qualify for chapter VII straight bankruptcy. As Prof. Vern Countryman explained:

> Voluntary composition and extension agreements have been successfully employed * * * but an involuntary composition or extension agreement forced upon a debtor seeking relief under chapter 7 can be expected to work about as well as compulsory marriage counseling for a spouse bent on separation or divorce. While voluntary compositions and extensions have worked under old chapter XIII and present chapter 13, they have been performed by debtors who, for what-

> ever reason, come into chapter 13 with some incentive to make them work. A debtor who is forced into chapter 13 could not reasonably be expected to have the same incentive or to make the same effort to produce the earnings necessary successfully to perform the plan, particularly if he is to be subjected to the rigors of the plan for a period as long as 5 years. Hearing, *supra*, at 142–143.

This is not unlike the incentives created by recent changes in medicare and food stamp rules which actually encourage the working poor to quit their jobs in order to qualify for these essential benefits.

Congress should not support a bankruptcy law which provides incentives to creditors to lend improvidently and incentives to debtors to remain or become unemployed in order to get a fresh start after bankruptcy.

V. Attorney Fees

While we have emphasized the serious problems inherent in the bill's future income test, other provisions of S. 2000 create additional problems, especially when applied in tandem with the above income test. The attorney fees provisions of the bill provide good examples. S. 2000 is likely to burden debtors with the attorney fee costs of defending against creditor challenges of their chapter VII application, even if they are successful in demonstrating that they are so far in debt that they qualify for chapter VII treatment.

Under current law, of course, there is no attorney fee provision with respect to creditor challenges of chapter VII filings because no threshold test must be met by a debtor to qualify for chapter VII. The only analogous provisions are those with respect to attorney fees for creditor challenges to discharge of particular debts. In cases of contested dischargeability, current law creates a presumption in favor of the award of attorney fees to prevailing debtors unless to do so would be inequitable. In sharp contrast, S. 2000 creates a presumption that attorney fees will not be awarded to the debtor who prevails against creditor challenges on the threshold test question or on the discharge of particular debts. Only if the debtor can demonstrate the creditor's bad faith in making the challenge would attorney fees be awarded.

The combination of the bill's attorney's fees standard and the anticipated future income test create an absurd burden on debtors. Not only will it become more difficult for debtors to file for chapter VII bankruptcies—if they do file, are challenged and prevail against the challenge—they may still have to pay the costs of having proved that they don't have enough money to pay their bills, let alone their attorney fees.

The law's current attorney fees provision, creating a burden on creditors to show that the award of fees to a prevailing debtor is inequitable, was designed to remedy creditor abuses found to be prevalent by the committees considering the 1978 legislation.

The House Judiciary Committee, for example, found that consumer finance companies frequently instructed loan applicants to list only their most significant outstanding debts. The forms used had a standard paragraph, however, which stated that the applicant had no debts other than those listed. If the debtor filed for bankruptcy, creditors

with these financial statements would often threaten the debtor with litigation to determine the dischargeability of the debt, based on the false financial statement exception to discharge. The threat of litigation and the attendant costs were often enough to induce the debtor to settle for a reduced sum in order to avoid the costs of litigation. H. Rep. No. 95–595, 95th Cong., 1st Sess. (1977) at 130–131.

The Senate Judiciary Committee explained that the provisions in current law were designed to deal with this problem by "discourag-[ing] creditors from initiating proceedings . . . in the hope of obtaining a settlement from an honest debtor anxious to save attorney's fees." S. Rep. No. 95–989, 95th Cong., 2d Sess. (1978) at 80. S. 2000's change in the standard for awarding attorney fees will encourage precisely those abuses which the 1978 act remedied. There is no justification for tipping the balance against debtors in this fashion.

The attorney fee standard in S. 2000 would have a particularly severe effect in situations where debtors attempt to discharge debts incurred close to the time of their filing for bankruptcy. S. 2000 creates a presumption that any debt incurred within 40 days prior to a debtor's filing for bankruptcy has been fraudulently incurred. Debtors inevitably will be discouraged from attempting to overturn this presumption since its existence makes the recovery of attorney fees for the successful challenge highly unlikely under the new fee standard.

Taken alone, the bill's attorney fees standards are unfair to debtors already in a severely disadvantageous position vis-a-vis their creditors. In conjunction with burdensome proof problems debtors will now face in qualifying for chapter VII, and in discharging their debts, the attorney fees provisions are unnecessarily harsh. Creditors want all the risks taken out of challenging debtors' ability to discharge their debts and qualify for a fresh start. There is simply no reason to insulate creditors in this manner.

VI. Myths About S. 2000

When exposed to the light of day, the justifications for S. 2000 offered by its proponents, especially by the proponents of the anticipated future income test, simply do not hold up. We have discussed some of the myths of the bill; namely, that the increase in the number of bankruptcy filings demonstrates a need to change our bankruptcy laws, that many debtors who file for straight bankruptcy can pay a large portion of their debts, and that the future income threshold test can be a fair, workable concept.

The following discussion addresses the remaining myths urged by proponents of S. 2000.

Myth No. 1: The Bankruptcy Reform Act of 1978 created the recent rise in personal bankruptcies

As noted above, the driving force behind the effort to amend the 1978 act is the often stated assumption that the recent increase in the number of personal bankruptcies has somehow been caused by the change of bankruptcy laws. Indeed, the lending community has trumpeted this fact in every available forum. But this fact fails to stand up to analysis.

It is undeniable that bankruptcy statistics reveal a rise in consumer bankruptcies. That result can hardly be unexpected given the economic climate. In fact, historically, bankruptcies have always increased during economic downturns. While personal bankruptcies rose 23 percent in 1980 and 30 percent in 1981, it is important to recall the jumps of 41 percent in 1949, 33 percent in 1954, 34 percent in 1961, and 33 percent in 1975. Letter, Berkeley Wright, Chief of the Bankruptcy Division Administration Office of the U.S. Courts, to Hon. Peter Rodino, chairman, House Judiciary Committee (July 7, 1981). Obviously these latter increases had nothing to do with current bankruptcy law since it remained constant through the years involved.

Skyrocketing business failures and business bankruptcies—which cannot relate to changes in the legislation governing personal bankruptcy—also contradict the inference that the 1978 act caused consumer bankruptcies to increase. Business failures reached their highest rate in 20 years during the first 2 months of 1982, according to Dun & Bradstreet. Weekly Failure Report, Business Economic Division, Dun & Bradstreet (March 23, 1982). Thus, it is completely unsurprising that business bankruptcy was up 42 percent for the first 10 months of 1981, reaching its highest rate since the early 1960's and its highest absolute level since the depression. New York Times (Nov. 15, 1981) section 3 at 1. Yet we hear no clarion calls for cutting back on business bankruptcy.

On close analysis, the claim that the increase in personal bankruptcy has anything to do with the Bankruptcy Reform Act simply falls apart. The eligibility criteria for entering bankruptcy were not changed in the 1978 act; they have, in fact, remained virtually the same since the 19th century.

Creditors have attempted to lay the blame for the increase in personal filings to the broader Federal exemptions adopted in the 1978 act. This argument is similarly misguided. First, over 30 States have opted out of the Federal exemptions preferring to have their own exclusions govern what personal property debtors may maintain when they file for bankruptcy. Bankruptcy rates in those States are no lower than the rates in States which use the Federal exemptions. Moreover, even in States where Federal exemptions could be expected to exert maximum impact on the decision to file, the data available does not support the conclusion that bankruptcy has risen at a higher than average rate. In Connecticut, for example, Prof. Phillip Schuchman found that the availability of a $7,500 homestead exemption—where one did not exist prior to the 1978 act—did not cause the State's bankruptcy filings to increase at a rate greater than the median rate for all other States. Hearing, *supra*, at 80.

Given the overwhelming evidence that bankruptcy historically relates to economic conditions and the failure of creditors to demonstrate specifically how the 1978 act caused the rise in personal filings, legislative action is inappropriate at this time.

Myth No. 2: Losses to creditors caused by increased bankruptcies are sufficient to justify a change in bankruptcy laws

Implicit in this debate over whether bankruptcy increases have been caused by the 1978 act is the assumption that the losses from

bankruptcies are harming creditors. In fact that assumption appears to be largely unfounded. Creditor losses because of bankruptcy amount to only 1 percent of total outstanding consumer debt. Federal Reserve Bulletin (March 1982) at A–42. Creditors are urging changes in the bankruptcy laws as part of a larger, very disturbing trend of activity by the credit industry: Seeking to foist all financial risks on borrowers, for example, by issuing adjustable rate mortgages with no limit on the increase in interest rates and by seeking to overturn all State usury limits. As bankruptcy must act as a financial safety valve when all other financial protections fail, only significant economic damage to creditors would justify wholesale changes in the Bankruptcy Reform Act. Such damage has not been demonstrated.

Myth No. 3: The purpose of the future income test is to capture the small number of deadbeat debtors

Both in their public statements and their testimony before the Congress, creditor representatives have stated that their purpose in seeking amendments to the Bankruptcy Code is solely to eliminate those debtors who abuse the current system. The examples they point to are high-income debtors attempting to walk away from debts they clearly could pay out of their future income.

We can all agree that such debtors should not be allowed to escape their debts. But the future income test in S. 2000 is in no way limited to such abuses. Instead, it applies to every debtor seeking to file straight bankruptcy.

The future income test is unnecessarily broad. In testimony before the House Judiciary Committee, Robert Evans, speaking on behalf of the Consumer Finance Industry, stated that the Johnson/Purdue study demonstrated that the future income test would be largely irrelevant to debtors with incomes below $15,000. In other words, according to Evans, the creditors' own study shows that debtors earning less than $15,000 will not be able to pay a reasonable portion of their debts out of future income. Yet they may still be forced to spend attorneys' fees and time to prove their inability to pay. Since the Shuchman study found that bankrupt debtors' median income was only $11,000, the future income test will force the great majority of debtors to waste time and money litigating the threshold test without any ultimate benefit to their creditors.

So while it may be true that creditors only seek to capture high-income abusers of the bankruptcy laws, they have cast their net in an overly broad, extremely expensive and very inefficient manner. The result may be a bankruptcy process that denies access to those most in need of relief. Presently, in metropolitan areas, it costs between $300 and $750 for attorney's fees in a simple bankruptcy proceeding. The future income test included in this bill, which can be invoked by any creditor, will require an evidentiary hearing, with attendant preparation and proof. Attorneys will raise their fees accordingly. As a consequence, S. 2000 may create an ironic situation in which only the high income debtors whom creditors seek to crack down on could afford to litigate their eligibility for chapter VII's fresh start relief.

Myth No. 4: By exempting people from the threshold test when undue hardship results, S. 2000 remedies the inherent problems with the threshold standard

S. 2000 attempts to mitigate the threshold test by exempting debtors who will suffer or whose dependents will suffer undue hardship is straight bankruptcy relief is denied. This exemption fails to remedy the basic flaw in the threshold standard, which is that the standard deprives people who are drowning in debt of the fresh start now provided by law if they relinquish their nonessential possessions. If debtors are denied that fresh start unless a bankruptcy court finds the denial results in undue hardship, the fundamental basis of traditional bankruptcy remedies will be lost.

At most, this undue hardship exception introduces additional vagueness and uncertainty for debtors who are struggling to recover from financial strains. Courts undobutedly will reach contradictory conclusions as to when denial of straight bankruptcy results in undue hardship. In virtually all cases, denial of straight bankruptcy will cause debtors and their dependents some hardship. But the point at which that hardship becomes undue will be judged differently from court to court. Moreover, as noted earlier, there is a strong likelihood that creditors will routinely challenge most chapter VII filings. This will create a tremendous litigation burden on all hard-pressed debtors, especially in view of the bill's attorney fees provisions.

Myth No. 5: Current bankruptcy law is unfair to creditors who are motivated mainly by a good faith desire to recover debts

Proponents of S. 2000 argue that existing bankruptcy law is unfair to creditors because it lacks tools which creditors need to collect unpaid debts of bankrupt debtors. Central to the issue of whether existing bankruptcy law is fair to creditors is the more refined question of how far should we let creditors go in collecting unpaid debts in a $300 billion credit economy in 1982? In 1971, the Honorable Asa S. Herzog, referee in bankruptcy, southern district of New York, wrote:

> In any reevaluation of the position of creditors, the unsecured creditor cannot come out unscathed. Creditors must share the responsibility for the rising tide of bankruptcies * * * inducing wage earners to buy, buy, buy, and charge, charge, and charge at enormous interest costs. Allowing those who obviously can't afford it to make huge purchases of clothing and appliances without making the slightest effort to check credit; swamping the country with precious pieces of plastic * * * Bankruptcy Tomorrow, 45 Am. Bankruptcy L.J. 65 (1971).

Leading up to the 1978 act, creditors had too often used bankruptcy law and law avoidance mechanisms which permitted them to exploit their superior economic positions in debtor-creditor relationships. Creditors' use of contractual and other legal remedies is replete with examples of overly harsh or overreaching conduct:

Using contracts written to their specifications, creditors took advantage of debtors' legal unsophistication to extract advance consents to default judgments without notice or hearings.

Creditors used contracts with boilerplate provisions whereby consumers waived exemption from attachment, or execution on real or personal property, including the waiver of homestead exemption rights.

Creditors extracted assignments of wage agreements authorizing employers to pay creditors all or part of debtors' wages, often resulting in severe hardship for debtors and their families.

Excessive use of third party contacts as harassment was the rule. Persons with no obligations for the debts, including spouses, employers, relatives, friends, and neighbors, received repetitive letters, telephone calls, et cetera.

Accordingly, in no sense is present bankruptcy law unfair to creditors. Rather, present bankruptcy law is a balanced response to the needs of debtors and creditors based on solid evidence of creditor overreaching.[9]

The provisions of S. 2000 are unwarranted and unwise and the bill should not be approved by Congress.

[9] H. Rep. 95–595, 95th Cong., 1st sess. (1977) at 121, 130–131; consumer credit in the United States, Representative of the National Committee on Consumer Finance (1972); hearings on H.R. 31 and H.R. 32 before the Subcommittee on Civil and Constitutional Rights of the House Committee on the Judiciary, 94th Cong., 1st and 2d sess., pt. 2 (1975–76) at 758–763; and F.T.C. report on credit practices, 16 C.F.R. pt. 444 (1978).

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